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Regulation

July/Aug 1979 AEI Journal on Government and Society

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REGULATION, *July/August 1979, Vol. 3, No. 4. Published bimonthly by the American Enterprise Institute for Public Policy Research.*

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Subscription rates: $12 for one year, $22 for two years (add $2 per year for foreign subscriptions). Single copy price, $2.50. Information on bulk orders or multiple subscriptions available on request. Editorial and business offices: c/o AEI, 1150 17th Street, N.W., Washington, D.C. 20036. Send changes of address and all subscription correspondence to Circulation Department, c/o AEI, same address.

Application to mail at second-class postage rates is pending at Washington, D.C.

"American Enterprise Institute" is the registered service mark of the American Enterprise Institute for Public Policy Research.

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ISSN 0147-0590

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Letters

We welcome letters from readers, particularly commentaries that reflect upon or take issue with material we have published. The writer's name, affiliation, address, and telephone number should be included. Because of space limitations, letters are subject to abridgment.

Saccharin and Cigarettes

TO THE EDITOR:

The American Council on Science and Health is a national group of scientists interested in promoting balanced evaluations of the public health and environmental issues that confront our society. We have recently published our own detailed report on saccharin and concluded that it should remain approved as a food additive without the need for a special warning label.

We agree with Dr. William Havender ("Saccharin and Human Risk," *Regulation*, March/April 1979) that the decision to use or not to use saccharin is the responsibility of the individual, not the government. We also agree that saccharin's alleged risks and benefits should be provided to consumers to allow them to make informed choices. However, in our opinion, warning labels are not the appropriate method for conveying this information.

The current warning label for saccharin is an obvious scare tactic and is, moreover, more strongly worded than the warning for cigarettes. As mandated by the Saccharin Study and Labeling Act of 1977, the following warning must be carried on all consumer products containing saccharin and be prominently displayed in all retail establishments (except restaurants) selling saccharin products: USE OF THIS PRODUCT MAY BE HAZARDOUS TO YOUR HEALTH. THIS PRODUCT CONTAINS SACCHARIN WHICH HAS BEEN DETERMINED TO CAUSE CANCER IN LABORATORY ANIMALS. In contrast, the warning required for cigarette packages and cigarette advertising reads: WARNING: THE SURGEON GENERAL HAS DETERMINED THAT CIGARETTE SMOKING IS DANGEROUS TO YOUR HEALTH.

Clearly, the risks from saccharin are insignificant compared with the risks from cigarette smoking. Yet these are the only two products subject to such labeling requirements. To equate these risks is to mislead the public. In any event, the saccharin label, like that for cigarettes, is seemingly ignored by most consumers. Sales of artificially sweetened products continue at pre-ban levels, and cigarette smoking is increasing among certain segments of the population. Efforts to improve public awareness about the risks encountered in everyday life should be an integral part of basic education, not promoted through sensational and misleading package labels.

Elizabeth M. Whelan, M.D.,
American Council on Science and Health
and Harvard School of Public Health

Cigarette Advertising

TO THE EDITOR:

Surprisingly, Gideon Doron is one of the very few commentators who recognize the principle that brand advertising does not result in overall market expansion (see *Regulation*, "Smoking and the Advertising Ban," March/April 1979). Among those who misunderstand this today are many who believe a ban on cigarette print advertising would be in the public interest.

A couple of additional points may be of interest to your readers. First, during the heyday of the anti-smoking broadcasting, 1968 to 1970, the consumption trend for cigarettes was not uniform. Sales declined by 3.7 billion units in 1968 and by 16.7 billion in 1969, but *increased* by 7.6 billion units in 1970. One cannot, of course, be sure of such a short-term trend, but the figures do bring into question the idea that a high level of anti-smoking broadcasting alone was a major factor in shrinking consumption.

Second, there is another reason for being cautious about the idea: In the late 1960s before federal revenue sharing came along, state and local governments were particularly in need of additional revenues and therefore many of them sharply increased cigarette excise taxes. The increases, of course, were passed along to consumers. While I cannot prove the point, economic theory would suggest that the higher prices may well have depressed demand in 1968 and 1969....

Third, the article mentions that per capita cigarette consumption consistently fell in the years 1964–1970 in the population eighteen and over. I do not know the source of these data. In any event, they may be skewed by the entry of a "bubble" of teenagers into the population in the later sixties—that is, entry of a group whose smoking rates (while too high, surely) are relatively low. In the conventional per capita measurement, there was an increase in cigarette consumption for two of the years referred to—1965 and 1966.

Also, the author's quotation from the American Cancer Society survey—"most teenage boys and girls now start to smoke before they are in junior high"—is a bit misleading. What the survey reported, I think, was that of the relatively small number of teenagers who do smoke, most began in grade school. However, I am not sure that the survey is to be trusted.

The final sentence in the article expresses "a certain sympathy for the FTC." If I interpret this correctly, it is an expression of the author's view that the federal regulatory authorities indeed have a responsibility to bring about reduced consumption of cigarettes. On that point we would differ. It is our view that persons who are considering whether or not to smoke are entitled to all of the relevant factual information they can get from any source, including the federal government. But the decision is the individual's responsibility, not the government's. In this situation, the individual decisions are "votes" that, taken together, express desirable public policy.

It is most unfortunate that the Federal Trade Commission and other agencies feel a compulsion to take direct steps toward behavior control.

William Kloepfer, Jr.,
Senior Vice President,
The Tobacco Institute

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Perspectives
on current developments

Trucking Deregulation—A Long Haul

President Carter expressed support for "substantial deregulation" of the trucking industry more than two years ago, in a speech in Clinton, Massachusetts. Though he promised to follow through with legislative proposals, his administration devoted its deregulation efforts first to airlines, then to railroads. And then, when the Council on Wage and Price Stability intervened in contract negotiations between the Teamsters and the truckers this spring, it was widely assumed that the White House had agreed to shelve trucking deregulation in return for a settlement sufficiently moderate to save the anti-inflation program. Thus many observers were surprised when, toward the end of May, the administration announced its intention to give trucking deregulation a high priority and began working out a common approach with long-time advocates of that policy on Capitol Hill. The resulting bill (the Trucking Competition and Safety Act, S.1400) was introduced on June 25 by Senators Kennedy, Ribicoff, Metzenbaum, Riegle, Tsongas, and Hayakawa.

S.1400 would gradually dismantle most—though not all—of the Interstate Commerce Commission's controls on interstate trucking.

- All route restrictions would be removed by December 31, 1981, and certain restrictions (such as prohibitions against intermediate stops between authorized service points) would be removed immediately.
- Entry barriers would be substantially lowered. Instead of requiring an applicant to show that the transportation services he would offer are "required by the public convenience and necessity," the plan would place the burden of proof on the applicant's opponents to show that the services would be *inconsistent* with the "public convenience and necessity." No challenges would be admitted against a proposal to provide service to a locality not yet served by authorized carriers or no longer served by railroad. In addition, the ICC and the Department of Transportation would be required to advise Congress by 1983 on the desirability of eliminating even these modified entry barriers.
- Existing antitrust immunity for collective ratemaking would be repealed (thus effectively prohibiting carriers from discussing and voting on rates, except for purposes of "interlining"). After two years, all restrictions on the lowering of rates would be eliminated (except that rates would still have to remain above incremental cost) and carriers would be allowed to raise rates without ICC supervision by as much as 5 percent a year for the first two years, as much as 7 percent a year thereafter.
- Existing exemptions from rate and route controls for certain agricultural products would be broadened to cover the trucking of all foodstuffs, processed agricultural products, and farm machinery.

Most economists believe that the case for deregulation of trucking is, if anything, stronger than the case for airline deregulation, since trucking is a less capital-intensive and more atomistic industry and therefore inherently more competitive. Trucking rates could therefore be expected to decline—at least, on the average, in comparison with other prices—in a deregulated environment. Though representatives of the trucking industry argue that the industry would become increasingly concentrated under deregulation, economists find it hard to see how a small number of carriers could drive up prices without attracting new entrants into a deregulated market. Evidence from unregulated trucking markets does not, in fact, seem to support the claim that deregulation would lead to high concentration—or, for that matter, to greater accident rates, another frequently heard argument against deregulation. There is, finally, very little to support the claim that deregulation would deprive small communities of

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current services, since the ICC does not force trucking companies to serve out-of-the-way places at present.

But if the economic case for trucking deregulation seems stronger, the political obstacles are greater than they were for airline deregulation. While lower rates might indeed expand the market for trucking services as they did for air passenger services, trucking companies in general might face a greater risk of deteriorating profit margins (because elaborate anti-competitive requirements of the ICC have given many truckers higher profit margins than airlines usually earned under the CAB). Consumers might not so readily appreciate the savings available to them from trucking deregulation, since the gains would be thinly spread across the prices of many commodities—instead of being reflected in dramatic price reductions in tickets purchased directly by the consumer. At the same time, the dependence of so much of the economy on trucking services, while increasing the potential gains from deregulation, makes any given risk seem that much larger. And trucking interests (including the Teamsters union)—numerous, well-organized and, by the nature of the industry, strategically placed in almost every congressional district—will surely spare no pains to keep Congress alert to those risks, however remote they may be.

Thus, despite the Carter administration's recent efforts, it is not clear there will be truly major legislative action on trucking deregulation in the near future. It is true that Senator Howard Cannon (chairman of the Commerce Committee, which recently gained primary jurisdiction over legislation in this area) has begun to show cautious sympathy. But a reform of this importance and complexity typically takes a long time to develop, and Congress will probably be less and less inclined to commit itself on the issue as the 1980 elections draw closer. Skeptics suggest, moreover, that the momentum for trucking deregulation will gradually dwindle as the initial achievements of airline deregulation fade from public consciousness and air fares fall victim to inflation.

Much, then, will depend on the readiness of the Carter administration to keep up the pressure. But the introduction of concrete deregulation proposals this summer of 1979 is still an important step, even if Congress is unable to act on them quickly. The experience with airline deregulation was that Congress was emboldened to take stronger action as the success of the Civil Aeronautics Board's initiatives toward liberalization of route and fare restrictions became apparent. The ICC, under promptings from the Departments of Justice and Transportation and from the Federal Trade Commission, has been experimenting with liberalization policies of its own over the past two years and, especially in the last few months, has been allowing trucking companies wider latitude in establishing new rates and routes. The results of these initiatives are likely to strengthen deregulation sentiment in Congress, which will in turn encourage the ICC to pursue liberalization policies more vigorously still. Thus, there is good reason to remain optimistic about trucking reform—over the long haul.

The High Price of Truth in Lending

The Truth-in-Lending Act has been hailed as "one of the Nation's most important consumer protection laws." Its requirements for disclosure of credit charges in all forms of consumer borrowing undoubtedly conferred on consumers much of the substantial benefit that Congress had hoped for when it adopted the measure in 1968. But now Congress is trying to amend the statute because it has apparently benefited some consumers—and their lawyers—in quite unintended ways and has required many businesses to provide a good deal more than information.

The disclosure requirement in the statute applies not merely to banks but to all forms of consumer credit arrangements, including, for example, the charge-card privileges or installment-buying plans of department stores. The great variety of institutions affected is one factor that has caused the implementing regulations devised by the Federal Reserve Board to grow to enormous length and complexity. Another factor is that most states have disclosure laws of their own, with the variation in these laws making it difficult for the Federal Reserve to devise standard disclosure forms for each type of credit arrangement. But the effort to make the reporting requirements as comprehensive as possible—covering even the most peripheral or technical aspects of credit arrangement with absolute precision—has doubt-

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less contributed most to the problem. This complexity has given rise to a great deal of litigation over fine details, and the court decisions resulting from the litigation have, along with other factors, impelled the Federal Reserve to revise the regulations continually, producing still further complexity.

Critics contend that this system has resulted in disclosure statements so technical and detailed that only a tiny fraction of consumers are able to make sense of them—or even read them through to the end. A more serious difficulty is that business managers have great trouble remaining in compliance with the shifting and confusing requirements, because they are never quite sure what the requirements are. Not long ago a court declared one lending institution to have violated Truth-in-Lending requirements even though officials of the Federal Reserve Board acknowledged that the institution's disclosure statement had followed the advice of the Fed's own official guideline pamphlet.

This leaves businesses peculiarly vulnerable to legal blackmail. Well over 50 percent—by some estimates as much as 80 percent—of Truth-in-Lending filings do not involve issues of real significance for consumer credit decisions. But the penalties available under the statute do not distinguish technical offenses from serious violations. The confusion and ambiguity surrounding requirements can thus turn the statutory "protections" into an offensive weapon for unscrupulous debtors.

The cases commonly concern not bank loans but merchandise disputes, arising from divorce, bankruptcy, or outright debt evasion proceedings. A typical case might find a consumer seeking to prevent a store from repossessing certain goods because he had fallen behind in his payments, and the consumer's lawyer filing a charge that the store had violated an obligation under Truth-in-Lending regulations. Some courts have even allowed consumers to file claims of "arguable violation" that do not specify at the outset the exact nature of the offense or the precise provisions of the regulations that were violated. Given the uncertainty prevailing under the present system, the store cannot be confident it has complied with all requirements in full. If it eventually loses the case, it will have to pay "formula damages"—a penalty of twice the finance charge involved with a minimum of $100 (maximum of $1,000)—and then pay the plaintiff's attorneys fees as well as its own. A number of

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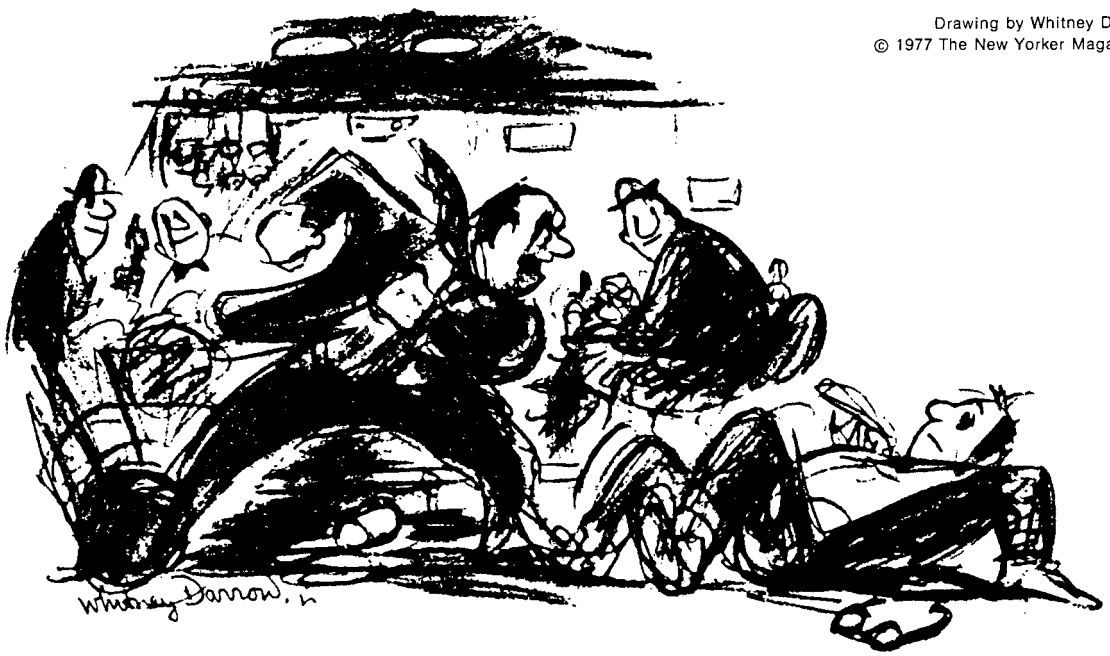

"The truth hurts, doesn't it?"

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courts, moreover, have held that if a debt is owed jointly by a man and wife (as is often the case), proven violations must be redeemed with double damages. In cases where the consumer debt involves anything less than $2,500, then, the creditor has an overwhelming incentive not to fight the charges and simply to settle out of court, by reducing or cancelling the complainant's debt.

The proposed Truth-in-Lending Simplification and Reform Act (S.108) is supposed to prevent such abuses. It would (1) simplify the typical Truth-in-Lending statement by reducing the number of required disclosure items; (2) allow creditors a slight margin of error for annual interest rate statements that fail to reflect minimal recent adjustments; (3) require the Federal Reserve Board to promulgate "model forms and clauses for common transactions," whose adoption by a business would assure it of being regarded in full compliance; and, perhaps most important, (4) narrow civil liability for penalties to "only those disclosures which are of central importance in understanding a credit transaction's cost or terms."

S.108 passed the Senate in a voice vote on May 1, 1979, but is encountering opposition in the House, as did the similar proposal adopted by the Senate last year. Reportedly, Representative Frank Annunzio, chairman of the Consumer Affairs Subcommittee, believes the bill would gut Truth-in-Lending "under the name of simplification" and has no plans to hold hearings.

But the Senate bill deserves more consideration. Its supporters make a strong case that it will, in addition to eliminating the potential for abuse, focus consumer attention on the most useful information and allow fuller monitoring of compliance by federal officials. If it is not a perfect solution, it certainly addresses a genuine problem.

Liberating Air Time

The Justice Department recently filed an antitrust action against the National Association of Broadcasters (to which some 70 percent of U.S. television stations belong) alleging a "conspiracy to restrain trade" in violation of the Sherman Act. It seems that the NAB's "overcommercialization rules" (which limit the number and format of television commercials) have caused the amount of broadcast time for advertising and public service announcements to be "artificially curtailed and restricted" and price competition has thus been "restrained and suppressed." According to the Justice Department, these limitations have boosted broadcasting profits by increasing advertising rates—while simultaneously inflating the retail prices of major products (to cover advertising costs) and inhibiting smaller producers from advertising.

Meanwhile—in an apparently unrelated action—the Federal Communications Commission announced that it would consider lifting its own restraints on advertising by radio broadcasters. An FCC staff study indicates that an overwhelming majority of radio stations broadcast fewer commercials than the maximum allowed by FCC regulations. Less than 1 percent of the stations sampled by the staff investigation had reached the limit of eighteen minutes per hour of commercial time—and more than 60 percent had exceeded the minimum requirement of 8 percent air time for news and public information broadcasts. FCC Commissioner James Quello stated that the data had persuaded him that in this area "deregulation is a good idea."

It turns out that radio broadcasters, too, have developed an NAB code that sets limits on the amount of advertising a station may carry. The FCC has voiced no objection to this voluntary code, however—nor has the Justice Department—since the commission's investigations indicate that market competition, rather than loyalty to the code, has been the principal factor in limiting the level of radio advertising. Since there are typically a large number of radio stations competing for listeners in each broadcast market, advertisers in this medium can spread their "spots" among a larger number of stations. By the same token, the stations compete more intensely for listeners—and some compete by offering fewer commercial interruptions on their programs.

A synoptic view of these two developments makes one wonder whether the Justice Department would not do better to direct its antitrust concerns at the FCC rather than the television broadcasters. The FCC has pursued policies with respect to both over-the-air and cable television that have "artificially" limited the num-

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ber of stations and programmers competing for audience and advertisers. Had it not done so, it seems quite likely that (1) TV broadcasters would not be in a position to arrange "artificially" low levels of advertising, (2) as in the radio industry, market forces would naturally produce low levels of advertising, and (3) the Justice Department would not have to risk public ridicule by invoking the majesty of the law to stamp out low levels of advertising.

Banking on Deregulation?

The Federal Reserve Board is not often classed with the Interstate Commerce Commission or the Civil Aeronautics Board. But some of the controls that it (along with other agencies) maintains on depository institutions are not very different in principle from the pricing and service regulations of the ICC or the old CAB. Nor are these financial controls obviously more justified than the transportation controls.

Since 1967, every successive administration has offered Congress its own comprehensive package of reform measures to streamline and liberalize the patchwork system of federal regulation that governs most of the country's depository institutions (which include commercial banks, savings and loan associations, mutual savings banks, and credit unions). None of the major proposals was ever enacted, but many have been accommodated in one way or another by the financial regulatory agencies themselves over the years. The reform plan unveiled by the Carter administration on May 22, perhaps reflecting both aspects of recent experience, is more modest in scope than its predecessors. But the changes involved are still sufficiently significant that Congress may be a long time in debating them. The Carter plan can be summed up in three main proposals:

(1) The key proposal is to phase out the existing system of interest rate ceilings on deposit accounts. At present the Federal Reserve Board's Regulation Q sets maximum interest rates for commercial banks belonging to the Reserve system (almost all large banks do belong and their deposits comprise some 70 percent of total U.S. deposits). The Federal Deposit Insurance Corporation enforces the same ceilings on nonmember banks that are federally insured (almost all of them are). In the case of the S&Ls, the ceilings are enforced by the Federal Home Loan Bank Board and, for most types of deposits, are pegged at one-quarter point above the maximum rate allowed to commercial banks. Under the administration's plan, all these rates would be allowed to rise to market levels, subject only to emergency actions to protect the soundness of financial institutions or implement basic monetary policy.

(2) The administration also proposes to restrict the effect of the present statutory prohibitions against payment of interest on checking accounts by allowing all federally insured institutions to offer interest-bearing transaction accounts (that is, accounts payable to third parties). The Federal Reserve Board did move in this direction last year with a regulation allowing banks to offer automatic savings-to-checking transfer accounts. But that approach was struck down by the D.C. Court of Appeals this spring (with the effective date of the court order delayed until next January, unless Congress changes the law before then).

(3) Finally, the administration's plan would allow S&Ls to invest up to 10 percent of their assets in consumer loans and to offer variable rate mortgages (on which interest rates are adjusted for changes in the general pattern of interest rates over the life of the mortgage). At present, S&L lending operations are essentially limited to standard home mortgages. The proposed change would compensate S&Ls to some extent for the loss of their quarter-point advantage on interest rate ceilings and for the extra advantage banks would receive from being allowed to pay interest on checking accounts.

The basic premise of these proposals is that a free market will provide a more efficient means of allocating consumer deposits among the different types of depository institutions—and ultimately of allocating capital across the economy. Under the current scheme, the official rationale for limiting the assets of S&Ls to home mortgages is that this increases the availability of mortgage funds for the housing market. But if the object is to subsidize housing, there are, in the view of most economists, more direct and efficient means than the imposition of artificial barriers on capital markets. Moreover, having locked S&Ls into long-

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term home mortgages at fixed interest rates, federal regulators have felt compelled to protect them from competition for deposits. (Otherwise, competition might bid up the interest rates that S&Ls must pay on deposits to levels that approach or exceed the rates they receive on mortgages.) Thus, if S&Ls were allowed to diversify their assets and to negotiate mortgages on a variable rate basis, much of the remaining rationale for interest rate ceilings would be eliminated. It would therefore allow S&Ls to operate more like commercial banks and open the way to the dismantling of many other restraints on both banks and S&Ls, since most of those restraints, many of which date back to the 1930s, are premised on the division of depository institutions into quite distinct industry segments with distinct political and economic interests.

The theoretical appeal of a market system is not the only impetus for comprehensive reform. The traditional framework of controls has been crumbling under the impact of sustained high inflation in recent years. This has forced depository institutions to adopt an array of complicated devices to evade unreasonably low ceilings on deposit interest rates. The financial regulatory authorities have often accepted, in some instances actively assisted, these novel arrangements, in order to avoid what they consider the greater evil of raising interest rates across the board. For example, in 1973 they removed ceilings on time deposits of $100,000 or more, and in 1978 they established a variable interest ceiling tied to the Treasury bill rate for so-called money-market time deposits of $10,000 or more. The authorities have feared that without these escape valves for banks and S&Ls, the economy would suffer the effects of "disintermediation"—the disruption of the normal "intermediary" or conduit function of such institutions between consumer savings and capital investment as depositors decide to invest directly in higher-yielding market securities rather than accept a low rate of return on deposits in banks and S&Ls. But these arrangements have tended to discriminate against the small saver (since they invariably require deposits in large amounts) and have also complicated the Federal Reserve's task of managing the money supply. Finally, more and more institutions have adopted variants of these escape-valve arrangements in the scramble to retain consumer deposits in these inflationary times and the industry has accordingly begun to experience the sort of discomfiting, intensified competition that it had all along expected regulation to forestall.

Thus, neither the public nor the regulated institutions themselves can find much satisfaction in the unwieldy system of controls now in effect. Almost all observers agree that further changes are inevitable. The likelihood, in fact, is that by the end of the century banking and savings institutions will have settled into patterns of operation quite different from those we are now familiar with. The real question is whether those changes will result from a continuing series of cautious rear-guard accommodations by regulatory authorities—or whether a comprehensive legislative reform will allow market forces to determine the pace and scope of change quite directly.

Cutting Corners on Samplers

In a very large organization, economy measures that are hastily imposed by central management often have unanticipated ill effects. Sometimes these may be severe enough to overshadow in the end the savings in view at the outset. But in a government agency as enormous as the Department of Health, Education, and Welfare, the adverse effects are rarely limited to the government itself.

The point is well illustrated by a recent decision of HEW's management staff to curtail the practice of paying respondents or interviewees who participate in opinion surveys conducted and sponsored by the department. Technically, the new rule on this subject, promulgated on April 30 as an amendment to HEW's *General Administration Manual*, was simply an internal management decision. It could thus be adopted without prior public notice in the *Federal Register* or prior consultation with the survey research firms that would be affected by it. Indeed, the management officials who made the decision were not legally obliged to consult even the HEW secretary or the operating units within the department that normally commission such surveys. Yet the rule's impact reaches beyond HEW: private polling firms have protested that it could have a disastrous effect on their professional activities, while also con-

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stricting the supply of new data to HEW decision-makers.

Survey research is widely employed by federal agencies, and is indeed frequently the cheapest way of securing basic data on the effects of existing government programs or the areas in which new programs may be necessary. HEW, for example, has surveyed pediatricians on the extent to which local children have been immunized against particular diseases and college students on the availability or adequacy of nongovernment sources of funds for tuition payments. The findings of such surveys are often the most solid evidence government officials have before them in making basic policy decisions. Almost always the work is contracted out to private firms, and it is their standard practice, in many types of surveys, to pay a small fee to those who agree to participate.

While management officials at HEW have not calculated the total expenditures made on such surveys—or the amount that might be saved by eliminating fee payments—they can point to clear instances of abuse to justify the new approach. Day-care providers who earn under $10.00 per hour have been paid $20.00 per interview for hour half-hour sessions on the effects of day-care centers. School principals have been paid over $200, and teachers over $7.00 an hour, to distribute and collect student questionnaires on the effects of public education. There has been, in fact, no incentive for contractors to limit the size of payments and in some sense there has been an actual disincentive, since survey firms are usually payed on a cost-plus basis.

Still, pollsters insist that it is difficult to get people to answer detailed questionnaires unless they are paid for their effort, but that a nominal fee often overcomes the difficulty. A few years ago, when the Office of Management and Budget questioned the need to pay college freshmen for participating in an Office of Education survey, OE commissioned a study which demonstrated that a fee of up to $3.00 markedly increased response rates, while raising the fee from $3.00 to $10.00 had little effect. The study also showed that it was cheaper to pay each survey respondent $3.00 than to follow up nonrespondents by telephone. Other studies have shown that the offer of compensation can produce "staggering increases" in response rates (from 18 percent to 40 percent in one instance, from 50 percent to nearly 100 percent in another).

The new HEW rule against fee payments does actually provide an exemption in circumstances where "the success of the data project would be severely impeded without the use of compensation." But to claim the exemption, prospective contractors "must provide substantiation that the data *cannot* be obtained without compensating respondents" (emphasis added). Subjective estimates of response rates, HEW management officials have explained, will not be sufficient to overturn the presumption against allowing payments.

Meanwhile, OMB rules require all government-sponsored or government-contracted surveys to yield an expected response rate of at least 75 percent (and while this standard may be relaxed under special circumstances, in no event may the expected response rate be less than 50 percent). To meet this standard without offering compensation payments to respondents, pollsters may resort to exaggerating expected response rates—with the connivance of HEW research officers anxious to have new contracts approved. At least that is the prediction of several experienced pollsters, who also predict that rigorous enforcement of the noncompensation rule would tend to drive the most reputable pollsters away from government research altogether. That is because shortfalls on the anticipated response rate may be discovered in OMB audits later on, with financial penalties assessed against the research firm in consequence. The best survey firms may not be willing to take such risks or engage in such practices, while the less reputable may pad their expenses in other ways to protect themselves against such risks. Research that is currently undertaken may simply be dropped.

If HEW research officers are upset about the effects of the new rule on their data sources, the polling firms fear wider consequences. They are most concerned that the rule may, as often happens, be adopted throughout the entire federal government and then, following another common pattern, be widely copied by business firms. Their fear, in other words, is that a routine management decision by HEW bureaucrats will force a debilitating change in the operating conditions of their entire profession.

With precisely such possibilities in mind, the Administrative Conference has for several

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years been urging federal agencies to follow the rulemaking provisions of the Administrative Procedure Act when establishing new restrictions on government contractors (even though the APA itself exempts rules affecting public contracts from its public notice-and-comment requirements). In this instance, the protests of research managers within HEW moved Secretary Califano to order a reconsideration of the new rule, which will doubtless afford the research firms—as well as the various program directors within the department—an opportunity to express their concerns and objections to the authors of the rule. Some sort of compromise can presumably be worked out. But the episode illustrates that federal agencies may be serving more than the business interests of contractors if they consult in advance with affected parties before introducing management changes of this kind.

Charity by Decree

Much federal regulation takes the form of conditions attached to participation in federal grant and loan programs. Institutions receiving financial aid often complain that these conditions place awkward or burdensome constraints on their independent activity. In recent years, funding recipients have complained that compliance with federal grant conditions can be quite expensive, too. It is usually assumed that the cost of compliance with these conditions can, in any case, never exceed the dollar value of the grants themselves, since the intended recipients would then refuse to accept them. But even this limitation on the regulatory power can be overcome, it turns out, by elaborating new "conditions" after the grants have already been accepted.

That is what the Department of Health, Education, and Welfare has done in its new regulations, issued May 18, revising the obligations of community hospitals under a grant program now more than thirty years old. The regulations require every hospital that has received federal financial assistance under the Hill-Burton program in the last twenty years to provide free medical care to patients who qualify as indigent. A hospital must provide this free care on a scale equivalent to 3 percent of its annual operating costs, or 10 percent of the value of its original grant, each year for twenty years after receiving the grant. These regulations, strengthening requirements initiated in 1972, have, as a spokesman for the National Association of Community Hospitals put it, "retroactively turned a grant program into a loan program with outrageously high interest rates—higher for many hospitals than what they could have gotten from private banks if they'd known what was involved."

HEW officials deny they are imposing these obligations retroactively, and it is true that hospitals were aware that *something* extra would be required of them when they agreed to accept Hill-Burton grants. Congress established the Hill-Burton program in 1946 to alleviate a shortage of hospital facilities in many parts of the country. Because of concern that marginal hospitals might use the construction grants to upgrade their facilities beyond the price reach of traditional clients in their localities, the program required that participating hospitals offer "a reasonable volume of services to persons unable to pay therefore." The legislation did not define "reasonable volume," however (nor "unable to pay"), and it allowed an exemption to any hospital for which "the requirement is not feasible from a financial viewpoint."

It was not until 1972 that HEW began to elaborate particular requirements under the free-care provision (or show much interest in enforcement). Under pressure from litigation by public interest groups, the department issued regulations at that time interpreting "reasonable volume" to mean 10 percent of the value of the grant or 3 percent of annual operating costs (with the choice left to the hospitals). But a third option was also allowed: an "open door" policy of guaranteeing free care to all indigent patients who requested it. More than 5,000 hospitals around the country were affected—since very few community hospitals had refused Hill-Burton assistance—and most chose the third approach.

HEW eventually decided to tighten these requirements, after investigation showed that many hospitals had failed to publicize their "open door" policies. At the same time, suits by "public interest" groups were successful in challenging various hospital practices to hold down expenses under the free-care program (such as refusing to waive bills for patients who failed to seek "free-care" status at the out-

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In Brief–

Ipse Dixit. In a speech delivered at the University of Kansas on January 25, Attorney General Griffin Bell characterized federal regulation as "a force more pervasive and more powerful than all the Union armies [occupying the South] during Reconstruction." Among his "few modest suggestions" to "assist in turning the tide," the attorney general urged that Congress "sharply curtail, if not abolish, the so-called 'rule-making' powers of the independent regulatory commissions." He warned that "rule-making is a total substitute for all other forms of government, executive, legislative, and even judicial. Its abuse can stymie and frustrate the government of whole states and the operations of entire industries."

Update: The Cost of "Mainstreaming." Controversy raged for almost a year over proposed regulations by the Department of Transportation that would have required cities to spend some $2 billion to make mass transit facilities fully accessible to the handicapped. The regulations were intended to implement a one sentence law (section 504 of the Rehabilitation Act of 1973) that prohibits discrimination against the handicapped in all programs receiving federal financial assistance (*Regulation*, November/December 1978, p. 7). Organizations of the handicapped pressed vigorously for the "mainstreaming" approach embodied in the regulations—construction of ramps, elevators, and other accessories to ensure ready access to transit facilities for persons in wheelchairs or with other disabilities; but critics pointed out that special van services could provide even more accessible transportation for the handicapped at far less cost. The final regulations issued this May essentially continue the mainstreaming approach, though permitting waivers for rail transit facilities "if substitute service is provided which is substantially as good or better" than the mainstreaming of existing services. Waivers will only be granted after public hearings and adequate justification. According to DOT officials, it will probably be at least two years before the department begins ruling on waiver applications in significant numbers.

The current regulations may not last that long, however. On June 11, the Supreme Court ruled in *Southeastern Community College* v. *Davis* that section 504 requires recipients of federal funding to refrain from active discrimination against the handicapped but does not require them to undertake affirmative action to assist the handicapped. The precedent is almost sure to inspire legal challenges to DOT's new requirements: it is hard to deny that $1.4 billion—DOT's current estimate of their cost—represents *affirmative* action.

Update: Sears Suit Fails to Sell. The ambitious suit launched by Sears, Roebuck & Co. last February was dismissed by the U.S. District Court for the District of Columbia on May 15. Sears had claimed that the contradictory requirements and policies of the ten federal agencies having civil rights responsibilities made it impossible for the company to attain a racially and sexually "balanced" work force (*Regulation*, March/April 1979, p. 6). The court, however, characterized the company's suit as involving "vague allegation of potential future injury" and found its claims insufficiently concrete for judicial resolution. Lawyers for Sears have not announced whether they will appeal. Meanwhile, the Equal Employment Opportunity Commission has taken its charges against Sears to court. *That* suit is still pending.

An Open and Shut Case. Wilson College, in Chambersburg (Franklin County), Pennsylvania, was founded in 1868 for the education of young women in the liberal arts. It was closed by vote of the trustees this past year (effective June 1979) with the dorms only one-third full, still an institution for the education of young women, still in the liberal arts (and some sciences). But in May 1979, Franklin County Judge John Keller, in a suit brought by the Save Wilson Committee (representing alumnae, faculty, students, and some trustees), ordered the trustees to keep the college open, removed Bryn Mawr President Mary Patterson McPherson from the board of trustees for conflict of interest, and also removed Wilson President Mary Waggoner from the board. Judge Keller held that the college, as a charitable trust, could not have its status altered without court approval, and that the trustees had failed their trust by not trying to improve matters (going coed or adding courses). The trustees are not appealing, and Wilson College is hitting the trail for new admissions and new funds. In view of recent testimony before the Senate Labor and Human Resources Committee that "in the early 1980s there will be a year in which there is an average of one college closing per week," the durability of the Wilson decision remains to be seen.

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set or charging off uncollectible bills to the "free-care" obligation on a rather indiscriminate basis).

The new requirements issued this spring are certainly tighter than the 1972 regulations. The "open door" option has been eliminated, even while hospitals are required to comply with an elaborate series of requirements to ensure that free-care offerings are adequately publicized. Though the old free-care obligation ran for only twenty years after a grant had been received, now hospitals that cannot fulfill their annual quota of free care (whether from insufficient local demand or pressing financial

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difficulties) must continue to provide "uncompensated services" at some level for as many years at it takes to "pay off" the equivalent of a twenty-year obligation. Moreover, the value of past federal grants, on which the annual 10 percent obligation is calculated, is to be adjusted upward for inflation each year to ensure that hospitals (unlike debtors or mortgage holders dealing with private banks) gain no advantage from delaying "payment."

The onerousness of these changes will vary from hospital to hospital, depending on the size of the original grant and the year it was received. Since the Hill-Burton grant program reached its peak in the mid-1960s, most community hospitals will not face more than ten years of further obligation under the new requirements. Others, though, particularly smaller hospitals with relatively large grants, may find themselves obliged to fund more than twice the value of their original grants in free care and, with deferred payments, may find their obligations stretching well into the 1990s. A few hospitals have suggested that they might try to free themselves of these obligations by refunding the value of their original grants to HEW (considering this a cheaper alternative even if they have to borrow the money to do so). Not surprisingly, HEW officials have indicated grave reservations about the legality of this counter-maneuver. Meanwhile, the department has not made it clear how it would reconcile the expenses mandated under its free-care regulations with the hospital "cost containment" bill it is now pressing for in Congress.

HEW predicts that the new requirements will encourage more poor people to seek medical treatment while probably steering greater numbers of them to hospitals with unfulfilled obligations. But since community hospitals rarely turn sick or injured people away because of inability to pay, the real burden of free-care requirements is hard to predict. In many instances the new regulations may simply transfer hard-to-collect bills into free-care write-offs. On the other hand, because the regulations define eligibility for free care exclusively in terms of current income (rather than income plus assets), hospitals may wind up providing free care to those who might otherwise have been asked at least for partial payment.

The major beneficiaries of this system will be low-income families headed by working parents, since Medicare already subsidizes hospitalization for the elderly and Medicaid covers families on welfare. Subsidizing the medical expenses of low-income families in general may well be a humane and sensible policy. But this is surely one of the more indirect and inequitable means of pursuing that policy.

Some hospitals may simply finance their free-care obligations by increasing the rates they charge to paying patients. Many, however, claim that a variety of regulatory constraints will make this impossible and force them instead to cut back on the quality of service they now provide. But why should sick people pay—in one way or another—a disproportionate share of the costs involved in this welfare measure? Why should the burdens of this subsidy fall more heavily on people who live near community hospitals that have received large grants or received grants more recently? Why indeed should the costs be borne only by paying patients at those nonprofit community hospitals eligible for Hill-Burton grants? And what is the logic of shunting poor families to more remote hospitals merely because the nearest facility may have already fulfilled its free-care obligation?

There is, it seems, no really satisfactory answer to these questions—except that a legislative authorization (of sorts) was available to HEW for an indirect regulatory scheme of this kind and not for the enlarged direct subsidy that would have made more sense. An extension of the existing Medicare programs would at once make all the new Hill-Burton requirements obsolete. So, too, would the national health insurance plan that HEW is now urging on Congress. In the meantime, though, the department, pressed by public interest groups, picked up what was at hand. Congress might do well to consider the surprising potentials that may be discovered in other old statutes.

Giving Minorities the Business

The Supreme Court recently agreed to hear arguments on the propriety of racial quotas in federal grant programs. On May 21, it granted an appeal of the court of appeals' decision in *Fullilove* v. *Kreps*, a suit challenging the constitutionality of a requirement in the Public Works Employment Act of 1977 that 10 percent

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of each grant made under the act be allocated to minority business enterprises. Though all the funds made available by the program have already been disbursed and contracts for all the projects involved already awarded, the principle at stake is far-reaching.

The Court of Appeals for the Second Circuit has ruled that the racial quota provisions of the public works act are a legitimate effort by Congress to remedy the effects of past discrimination in the construction industry. According to the court, the quota program implied a congressional determination that such remedial action was necessary and was thus distinguishable from the university-determined admissions quotas repudiated in *Bakke*. But not all federal courts agree that Congress is free to enact racial quota schemes simply on the basis of a generalized concern to remedy the unspecified effects of "past discrimination." In a parallel case (*Associated General Contractors of California* v. *Secretary of Commerce*, 1977), a U.S. district court judge struck down a similar quota scheme in the Local Public Works Capital Development and Investment Act of 1976.

The Supreme Court's decision in *Fullilove* may settle the constitutional status of a range of similarly designed programs. The oldest and costliest is the minority business program of the Small Business Administration established in 1968. One portion of the program requires government agencies to set aside a certain share of their contracts for minority businesses on a noncompetitive basis. (In contrast to the contract quotas in *Fullilove*, the SBA's set-aside program actually does allow for participation by non-minority firms that prove they are "socially disadvantaged." But the program places a burden of proof on these firms which minority firms are officially exempted from—for them, minority status is sufficient, as in the *Fullilove* scheme.) Later Congress decided to supplement preferential access to government contracts with grants for the purchase of equipment and loans for working capital to aid minority businesses. The SBA has given out more than $2.8 billion in loans and grants for these purposes over the last decade.

It is worth noting that the results of all this effort have not been encouraging. Of the 3,400 firms that received special minority assistance from the SBA over this period, only 30 have "graduated" to the status of viable businesses, able to go on without further government assistance, according to the SBA's own figures. Innumerable abuses have been documented in which minority firms used SBA funds to buy personal luxuries or acted simply as "fronts" to channel "set aside" contracts to nonminority firms.

Scandals at the SBA have not by any means been restricted to the minority business program. Reports of favoritism and recklessness in the disbursement of funds have been routine since the agency was founded more than twenty-five years ago. Last November, Senator William Proxmire (Democrat, Wisconsin) urged that the SBA be eliminated altogether, describing it as "a repository of patronage and scandal that has helped only a small number of small businesses."

A good deal of this misappropriation is surely inevitable, given the character of the SBA's primary mission: providing capital to small firms whose prospects are too uncertain to secure adequate financing from commercial sources. It remains for the Supreme Court to determine whether the minority business program contravenes a higher and more fundamental principle than economic rationality.

Worth Noting-

"Visit the countries in Europe, especially those with socialist governments, and you will discover their regulations are much more reasonable, more cost conscious, more sophisticated in the application of cost-benefit analysis than ours. The only reason I can think of is that socialists in Europe take responsibility for the economy. Regulators in this country do not."

Irving Kristol

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Viewpoint

Suzanne Weaver

Inhaber and the Limits of Cost-Benefit Analysis

In January there was an exchange in the *Washington Post* between Mark Green of Congress Watch and Peter Schuck of the American Enterprise Institute on how much cost-benefit analysis could be reasonably used for the purpose of social regulation. I read through that exchange and, unsurprisingly for a representative of the *Wall Street Journal*, came to a somewhat different conclusion from Mr. Green's. Yet as I read his article, I was struck most of all by the extent to which I agreed with his analysis.

His argument, to quote from the *Post* article (January 21, 1979, section C1), is that "given the state of economic art, mathematical cost-benefit analyses are about as neutral as voter literacy tests in the Old South." That is not exactly a dispassionate way of putting it, but I think he is on to something. It may well be that by thinking explicitly about costs and benefits, even apart from the final verdict one reaches in a given case, one injects something into the debate that is not politically neutral and is, in some fundamental way, hostile to a large part of the current movement for social regulation.

This possibility came to me quite powerfully out of a piece of work that I did recently, part of whose results appeared in the *Journal* as a feature piece. The subject was the report produced a couple years ago by Dr. Herbert Inhaber, a physicist working for the Atomic Energy Control Board of Canada. Inhaber made a first cut at going through the existing literature on the risks associated with various energy sources, in an attempt to figure out how the sources ranked relative to one another.

The *Journal*'s involvement with the Inhaber report began some months ago when an article in the paper by another author mentioned the document in passing. Following that mention, a strange thing happened. Our features editor, Tom Bray, began to get detailed and passionate mail on the subject, telling what an egregiously bad piece of work the Inhaber report was. Some of this mail directed our attention to studies that, we were told, destroyed poor Inhaber quite completely. Tom Bray—being, among other things, a first-rate journalist—thought that if Inhaber could make so many people so mad, he must have struck a nerve somewhere. I was asked to see what all the noise was about.

It turned out that Dr. Inhaber had backed into these attacks by attempting a variety of cost-benefit analyses. What he set out to do was to make a pretty straightforward calculation of various kinds of energy risks. He took all the literature on the various energy sources—conventional systems like coal, oil, and nuclear power, as well as the newer and more decentralized technologies like wind and solar energy—and he added up the various risks to life and limb from each of them, all the way from the mining of the materials necessary to constructing each system, through the generation of power (including the back-up facilities needed by decentralized systems), to final waste deposit. The resulting report was fairly widely distributed, in no small part because Inhaber was the first person to do the unattractive but useful work of going through all the existing sources in the field and making the rather tedious calculations necessary to extract some kind

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of comparable data from them. But Inhaber's report also got attention because it reached a rather startling conclusion. He said that the energy systems some people have touted as "clean," like solar energy and wind, could actually be riskier to society than some conventional systems, including nuclear power.

In retrospect, it is no great mystery why Inhaber's method of risk analysis would come up with such a conclusion. There are two kinds of structural reasons that contribute to the final verdict.

First, when one deals with a power source like nuclear energy, the maximum risks may be huge, but they are also remote. So any risk assessment method that counts both these factors will judge nuclear energy as relatively safe. Second, some of the new decentralized technologies are at the moment relatively inefficient and unreliable compared to the older systems. The low efficiency means that relatively large collectors are needed. Large collectors take substantial amounts of material to build. And these materials pose risk to life and limb as they are mined, manufactured, and transported. Further, the low reliability of the new systems makes it necessary to take account of their back-up systems, and add the attendant risks of those into the final risk total.

One can begin to see some of the structural problems with a method like the one Inhaber used. Moreover, there are limitations from obvious and ordinary failings in the data—from the gaps, the ambiguities, and the errors in some of the studies, and the lies as well. Also, it is hardly likely that any researcher doing the first comprehensive collection job in this area can avoid contributing some plain ordinary mistakes of his own.

Besides those kinds of problems, there are middle-level conceptual problems that risk assessment of this sort is only beginning to deal with. For example, is it helpful to count up all the risks involved in huge solar collectors, if in fact the solar collectors will not be built until some way is found to bring the size down and the cost into line?

There are also the larger conceptual dilemmas. For instance, are there some possibilities connected with some kinds of energy production that are so horrible that it is quite reasonable to refuse to risk them now no matter how remote the chances of their occurrence? Or are there some kinds of dangers—for instance, the risk of producing a deformed child—that should be counted as being worse than illness or death or shortened lifespan?

As can be readily imagined, people wrote to Inhaber and the Atomic Energy Control Board with criticisms like this and, as a result, his report has been undergoing continual updating and correction. But none of these limitations explains the phenomenon that I was asked to investigate. The letters the *Wall Street Journal* was getting about the Inhaber report were not filled simply with criticism and suggestions for amendment. Instead, admitting to having no interest in amending the Inhaber report, they thought it would be better if the document were obliterated altogether. They said the report deserved obliteration because it was so badly done, but made no attempt to improve upon its analysis, or come up with a fundamentally different conclusion.

The chief opponent of the Inhaber report has been John Holdren, a Berkeley physicist active in the movement against nuclear power and in promoting research into nonconventional energy sources. In their letters, it is true, Dr. Holdren and his allies have included specific criticisms of the report. They have argued that Inhaber overestimated material requirements for windmills, used conservative assumptions for some nonconventional energy sources that he did not apply to other systems, and misquoted sources on the various kinds of conventional energy waste disposal risks. But in addition to the specific criticisms, these various letters and publications have also assailed Inhaber with a most extraordinary kind of general invective. They have charged not only that he is in error, but also that he is deliberately lying. They have called his document "by far the most incompetent technical document . . . ever known to have been distributed by grownups." They have called it "garbage" and Inhaber a "buffoon." They have claimed flatly that any expert who defends the report either has not read it or is not an expert (which, in fact, is not true).

They have attempted, when talking to me by telephone, to make contact with my dim journalistic mind by explaining that they have used all these strong words because their situation is similar to that of the journalists who attacked Watergate. We had used very strong language, I was told, to bring home the horror

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of the Watergate offense against society and, for the same reason, they were using strong language to attack Inhaber.

Even for scientific controversies this is a very strange and, of course, grossly indecent way to conduct a debate. And for a while, I confess I was mystified by the spectacle. But now I realized that Inhaber's critics were precisely right to be so upset. The offense of a document like this is not that it opts for one energy system over another. Instead, what is really going on is that it launches, in large part unintentionally, a much more dangerous kind of attack. A document like this operates on the assumption that the risks of the various energy sources may be different in degree, but are not in critical respects different in kind; if they were different in kind, one could not presume to compare them on any scale whatsoever.

To put it another way, the method of inquiry in the Inhaber report asserts by implication that energy sources are all somehow ethically equivalent and that they can, in the large, be judged according to the same standards. The enterprise suggests that a person who argues for one energy source over another cannot legitimately be judged a friend or enemy of the people simply by the choice he finally makes.

This kind of comparison takes a subject that has been spoken of in moral absolutes and presents it as something uncertain, ambiguous, subject to doubt and, perhaps, to compromise. Making an assertion like this—saying that an area of inquiry is subject to doubt—may seem a minimal thing. After all, it certainly does not guarantee what one's verdict will be in a particular case. One might follow a method like Inhaber's and then decide to ban nuclear power, or a suspected carcinogen, altogether. But Inhaber's kind of discourse is, in spite of such uncertainties, a significant threat to the strategy by which today's new regulation has been making its gains.

The argument surrounding much of the new regulatory movement is that technological capitalism is poisoning people. The corollary of the argument is that the poisons produced by this capitalism must be removed from the environment, that this is the only ethically responsible course for public policy to take, that those who raise cost considerations should not be trusted because their arguments are only smokescreens thrown up by the forces of greed.

. . . Inhaber's kind of discourse is, in spite of . . . uncertainties, a significant threat to the strategy by which today's new regulation has been making its gains.

For instance, Mark Green, in that *Washington Post* article, says that cost-benefit analysis might have prevented the Salk polio vaccine from coming on the market. He says cost-benefit analysis would have killed the idea of abolishing slavery. He says it would never have supported the child labor laws. He tells us that we cannot put a price on the child who can be saved from disfigurement from flammable sleepwear, or a price on the worker who is saved from asbestos-induced cancer. And the implication, which in its own way pollutes—indeed, poisons—the debate on regulation, is that those who talk in terms of cost-benefit analysis do not care about the child, do not care about the death.

I agree that these worries about children and lives are worries of the most profound kind. But in a way I think the people who have been attacking cost-benefit analysis in this way have not expanded their field of moral worry far enough. For instance, on the matter of toxic chemicals, we are increasingly able to discover more not only about the toxic character of the workplace, which is serious enough, but also about the toxic character of natural processes. To take one example—and this is not a smokescreen, but a set of issues that at some point we must face in terms of public policy—by now we are aware of huge numbers of carcinogens occurring naturally in the food supply, in foods ranging from fish to green vegetables. Does our growing knowledge of these things come without some obligation to act? And if we do have to act, how can we do so without some form of cost-benefit analysis, imperfect though it may be?

Mr. Green is right in calling attention to the fact that cost-benefit analysis is the enemy of the unbridled agenda of social regulation that he has been promoting. But I think we will soon reach the time when regulatory trade-offs in this area cannot be avoided. It might be good for public debate on the issue if more people began to point this out. ■

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The Business Roundtable Study

COUNTING THE COSTS

Marvin H. Kosters

For which of you, intending to build a tower,
sitteth not down first, and counteth the cost,
whether he have sufficient to finish it?
Luke 14:28

ECONOMIC ACTIVITY is increasingly influenced by an extensive network of federal regulatory programs, much of it introduced in the past ten to fifteen years. Its goals are desirable—reducing the adverse environmental effects of economic activity, lessening risks of accidents and exposure to substances that imperil health, enhancing the amount and quality of information available to consumers, and improving equality of access to education, training, and jobs. But when this network was being built up, there was little appreciation of what it might cost to achieve these goals. Indeed, not much information was generally available on probable costs and they were usually not a major consideration in the debates leading to new or expanded regulatory programs.

Both the lack of good information on costs and the limited attention focused on them are attributable in part to the way these costs are financed. Public goods provided by government —highways, for example, or parks, or national defense—have traditionally been financed largely by collecting tax revenues and using the funds to buy from the private sector what is required to provide these goods. Estimates of costs for programs of this kind are part of the normal administrative process of budgetmaking. Regulatory costs, in contrast, are largely hidden from view—because they are included in prices paid by consumers or reflected in reduced returns to owners and shareholders. Thus estimates of these costs are not an automatic by-product of traditional administrative and accounting processes. The costs are no less real, however, than those that appear explicitly in public budgets; both represent resources that could be used for other purposes.

Greater interest in the magnitude of regulatory costs can be traced to several sources. Newly established or expanded federal regulatory programs have increasingly been recognized as producing mounting costs for compliance. This has raised questions not only about the amount of resources being devoted to the various regulatory goals, but also about wheth-

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er in particular instances these costs might exceed realized benefits and whether alternative approaches might make possible lower costs, higher benefits, or both. At the same time there has been growing skepticism about the effects of more traditional regulatory programs involving price, service, and entry controls.

A body of analysis and evidence has been developed suggesting that, in these traditional areas, reform—including complete deregulation, in some cases—would reduce costs without correspondingly reducing benefits. This interest in reform, both of the traditional "economic" regulatory programs and of the more recent "social" regulatory programs, has been stimulated by the experience of persistent inflation—an experience that concentrates minds on reducing costs or at least limiting the thrust of cost increases.

Regulatory Cost Estimates

In recent years a number of efforts have been made to measure regulatory costs. Some of these have been carried out by government. There have been, for example, studies by the Council on Environmental Quality and the Department of Commerce on the costs of pollution abatement regulations, and by the Council on Wage and Price Stability and the Regulatory Analysis Review Group for a broader range of regulatory programs. Studies have also been carried out at universities or research institutions; the work of Murray Weidenbaum and his associates at the Center for the Study of American Business (Washington University) is a widely cited example. In addition, some major companies—including Dow Chemical, General Motors, Ford, Caterpillar, and R. J. Reynolds—have made internal estimates of costs attributable to regulation. Among the studies that have emerged from the business community, the one carried out by Arthur Andersen & Co. for the Business Roundtable appears to be the most detailed and carefully documented.

An important feature distinguishing the Business Roundtable study from most earlier studies is that it applied a consistent methodology for estimating costs to *all* the firms involved and for *each* of the regulatory agencies or programs considered. Previously, cost estimates have been made for a specific regulation or proposal, for a particular firm, and for broad categories of regulations (in an effort to examine the economy-wide impact of regulation). These studies used different methods for constructing the estimates and different concepts for determining what should be counted as costs. All the estimates, of course, are subject to varying degrees of uncertainty and error. While estimates of the cost of regulation are always approximate and often quite crude, differences in methods and concepts used for cost measurement are an important source of differences in estimates.

Even in principle, there is no single answer to the question, What is the cost of government regulation?, without defining more specifically what is meant by costs. Nor do cost estimates by themselves provide sufficient information for judging whether a regulation is worthwhile. Both for defining what is meant by costs and for determining whether incurring the costs is worthwhile, it is necessary to make comparisons. Benchmarks must be established for measuring regulatory costs, and these costs must then be compared with the benefits attributable to the regulations.

The Business Roundtable study is essentially an analysis of costs, not of benefits—as is my discussion here. This does not mean that benefits do not deserve careful attention and measurement to the extent feasible. Both the proponents of a benefit-cost framework for evaluating regulation and its critics agree that it is essential to consider benefits, with the former usually arguing that they should be weighed against costs and the latter usually arguing that, in the process, benefits are likely to be given too little weight.

The Cost Measurement Methodology

In general terms, costs attributable to regulation are measured by the difference between the costs that occur in the presence of regulation and the costs that would prevail in its absence. This basic idea may seem quite straightforward, but its application can be complex. Determining what would have occurred in the absence of regulation—which is what establishes the benchmark or point of reference for cost measurement—involves a considerable amount of judgment.

The Business Roundtable study's incremental cost method, along with the example

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given to describe it, is a case in point (see Michael Simon's article, Table 1, page 21). EPA's water pre-treatment standards require removal of 99 percent of certain pollutants. The costs of achieving this standard were compared with the costs of 95 percent removal. The rationale for choosing this reference point is described in the study as follows: "In its [the company's] opinion based on scientific research and studies, introducing 5 percent of the incompatible pollutants into the county's treatment works would result in no measurable damage to the county's system and no detrimental effects downstream." This rationale is, of course, couched in somewhat antiseptic technical terms ("scientific research . . . no measurable damage . . . no detrimental effects"), but this should not be allowed to obscure the reality that the level of abatement that would have been set in the absence of regulation remains a matter of judgment. Indeed, this is recognized in the study by reference to such factors as social pressures and market conditions.

The example also raises a substantive point. Taken at face value, it suggests that essentially no benefits should be attributed to removing *more* than 95 percent of the pollutants involved. This interpretation implies that, even in the absence of regulation, too much would have been spent on removing these pollutants—in the sense that costs are being incurred to the point where the benefits of further removal are of no value, instead of to the point where their value is equal to the costs of further abatement. This is obviously not intended to be the main point of the example, but it shows that the firm's judgments about the appropriate benchmark for cost measurement are made with benefits in mind. Moreover, the example shows that the implications of technical measures of abatement performance can be better understood by expressing them in ways that permit them to be compared with costs.

The exercise of judgment in constructing estimates of the costs of regulation is unavoidable. There is no reason to suppose that the participants in the project did not exercise sound judgment, or that they were not in the best position to make sound judgments. If firms were inclined toward exaggerating the costs of regulation, they could do this by establishing low-cost reference points for comparison. On the other hand, however, the costs of regulation would be underestimated if firms were inclined instead to exaggerate the extent to which they would have devoted resources to pollution abatement, improved safety, or other worthwhile goals in the absence of regulation. Some resources would have been devoted to these goals (because this would have been sound business practice in terms of a firm's economic self-interest and its relationships with the broader communities of which it is a part). While there is no reason to suppose that these (and other) possibilities are equally likely and would operate to balance each other exactly, the direction of possible biases in the overall results is unclear.

Certainly the appropriate amount of resources might well not be devoted to these goals in the absence of regulation. Indeed, the rationale for much of our current regulation is presumably a judgment that insufficient resources would otherwise be devoted to these worthwhile goals. Much of the controversy about regulation and estimates of its costs is concerned with how cost information should be used in judging what amount of resources is enough.

The treatment of expenditures made for capital equipment is another issue that merits discussion here. Under the methodology of the study, these expenditures were simply aggregated along with those for annually recurring operating expenses incurred during the same year. Capital equipment, however, is not used up during the current year, the investments having been made in order to deliver benefits over a period of years. Cost estimates might take this into account by including only the portion of capital investments that represents an appropriate annual charge for the use of the capital. Estimates developed along these lines would, of course, require reaching back to measure the amounts of capital investment occurring in earlier years and assigning annual costs charged to these earlier investments. This would be a more ambitious undertaking. But the resulting estimates would correspond more closely in concept to conventional measures of annual production and costs, in which investment expenditures are amortized and annual depreciation charged as a cost. Under the method employed in the study, however, the estimate of annual aggregate costs must be in-

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The Business Roundtable Study

What We Did

Michael E. Simon

THE BUSINESS ROUNDTABLE study is unique among studies of regulatory costs. It covered a significant number of regulatory programs. It applied uniform, verifiable principles for measuring costs to a substantial number of large companies. And it drew upon the accounting data and personnel of the companies in question. Thus, in my opinion it is useful not only for its conclusions about specific costs, but also because it demonstrated a methodology that can be extended to even more comprehensive efforts of its kind.

The study was carried out by Arthur Andersen and Co. for the year 1977 and enlisted the participation of 48 of the Business Roundtable's 192 member companies. Our first task was to narrow the study's scope—which we did by balancing the aims of completeness and practicality according to three criteria: the agencies and programs selected should involve a significant portion of federal regulatory costs, the regulations should affect a wide range of industries, and finding the relevant data should not require unreasonable amounts of manpower from companies participating in the project. The six regulatory areas chosen included four agencies—the Environmental Protection Agency (EPA), the Occupational Safety and Health Administration (OSHA), the Department of Energy (DOE), and the Federal Trade Commission (FTC)—and two programs—the Employment Retirement Income Security Act (ERISA), and equal employment opportunity (EEO).

After choosing these, we developed procedures for data collection, established principles for analyzing the data, and trained the company project teams in the approach.

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The forty-eight companies that participated in the study operate in more than twenty industries and comprise an important segment of the U.S. economy. In 1977, they accounted for about 8 percent of the sales of U.S. industry, 5 percent of civilian employment (excluding agriculture and government), and 19 percent of private sector capital expenditures for plant and equipment. However, since no small businesses participated, and since the industry representation was very uneven, we did not attempt to extrapolate our results to all businesses in the economy.

Incremental Costs. The most important principle underlying our methodology is that of incremental costs. Rather than ask the companies to include all actions taken to comply with the regulations in the six areas—whether or not those actions would have been taken without the regulations—we decided instead to ask them only for the costs of actions they would *not*, in their judgment, have taken in the absence of regulation. Accordingly, project teams were told to assume a 1977 environment in which federal regulation had never existed, but in which all other factors (such as social, interest group, and marketplace pressures) were present; and company chief executive officers were requested to review the judgments made. This incremental cost approach reflects the fact that managements would indeed make different judgments about the use of resources in the absence of regulation. By requiring participating companies to make those judgments, we came up with measurements of the costs directly attributable to the regulations in question. Table 1 illustrates one calculation of incremental costs.

In addition to the incremental costs of regulation, there are, of course, indirect or secondary costs—which many companies believe to be larger. These include lost productivity, delays in construction of new plant and equipment, misallocation of resources, and lost opportunities. Though our report describes some of these costs, they were excluded from our calculations because of the difficulty of identifying and measuring them from the records of business firms.

Results of the Study. In the six regulatory areas covered, the forty-eight participating companies incurred $2.6 billion in regulation-induced incremental costs in 1977 (see Table 2)—considering much of it to be wasteful. The significance of the amount may be measured by the fact that, in

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1977, these companies had total capital expenditures of $25.8 billion, R&D of $6.0 billion, and profits after taxes of $16.6 billion. The manufacturing sector was more strongly affected than services, transportation, and communications. Its share of the incremental costs was $2.3 billion, which compares with capital expenditures for this sector of $13.4 billion, R&D of $5.4 billion, and profits after taxes of $10.2 billion.

Adding to the significance of the $2.6 billion figure is the fact that two-thirds of it consists of operating-and-administrative and product costs. These types of costs recur each year.

Two points about incremental capital costs merit emphasis. First, illustrating the differing effects of regulation from industry to industry, these amounted to 3.3 percent of capital expenditures for all participating companies but 19 percent of those expenditures for the primary metals companies.

Second, many of the capital projects active in 1977 were, of course, begun before 1977 or ended after 1977. For those projects active in 1977, $1.6 billion in incremental capital costs was incurred prior to 1977 and an estimated $1.4 billion was to be incurred after 1977. Thus, for each $1 spent for incremental capital costs in 1977, $3.50 was spent in prior years or would be spent in later years to start or complete *the same* capital projects. This $3.50 is *not* included in our totals. Also not reflected is the estimate that capital projects active in 1977 will *increase* recurring annual incremental operating costs by $305 million (not including depreciation).

Incremental costs of regulation are ultimately passed on to the consumer in the form of increased prices or to the shareholder in the form of diminished equity. The full $2.6 billion passed on to the consumer would, on average, raise prices of the products of the participating companies by 1.1 percent. Thus, these costs add to inflation and adversely affect the ability of U.S. industry to compete at home and abroad.

Conclusions. While the Business Roundtable study has limitations—the key one being that it does not measure indirect regulatory costs—it makes three major contributions. First, its findings, both the general observations and the detailed statistics in the 500-page appendix, can help identify those regulations that need further scrutiny and possible reform.

Second, the study identifies some of the attributes of regulations that impose high costs.

Table 1

CALCULATION OF INCREMENTAL COST

Steps	Example
Company identifies an action taken to comply with a specific regulation.	Installation of waste-water pretreatment system to remove 99% of pollutants in compliance with Title 40 *CFR*, Chapter 1, Part 128.
Would action have been taken otherwise?	Pretreatment system without Title 40 would have been designed to remove 95% of pollutants.
What was the cost of the action?	$1,200,000 (from fixed-asset ledger data).
How much would the action that would have been taken in the absence of regulation have cost?	$800,000 (the cost of installing a 95% system, updated from earlier fixed-asset data).
What was the incremental cost?	$1,200,000–$800,000 = $400,000.

Table 2

INCREMENTAL COSTS
(in $millions)

Area	Operating & Admin.	Capital	Product	R&D	Total
EPA	623	765	555	75	2,018
EEO	209	8	—	—	217
OSHA	103	68	2	11	184
DOE	70	28	10	8	116
ERISA	61	—	—	—	61
FTC	23	1	—	2	26
Total	1,089	870	567	96	2,622

These attributes include requiring new equipment or retrofitting, specifying standards that cannot be met with existing technology, prescribing predetermined compliance methods or engineering solutions that leave no flexibility for other ways of reaching the same goal, forcing recurring operating, maintenance, or monitoring costs, and setting unclear rules or changing rules in midstream.

Third, and perhaps most important, the study demonstrates that it is possible to apply a uniform and credible method for determining incremental regulatory costs to a large number of companies in a wide variety of industries. The challenge now is to extend the use of this methodology in order to improve our understanding of a significant part of the regulatory burden. ■

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terpreted as a measure of the amount of resources withdrawn from other uses during the current year to meet regulatory goals, instead of as the amount of resources actually used up during the current year.

Types of Regulatory Costs

Costs attributable to government regulation arise in different ways, and different classes of costs should often be treated differently. Moreover, costs in some classes are susceptible to measurement using the methodology employed in the Business Roundtable study, while others are not. It is, therefore, useful to distinguish various classes of costs arising from government regulation in order to place cost estimates and the methodology used to develop them in perspective. I will, for this purpose, distinguish four classes of regulation-induced costs, even though it would be possible to define narrower sub-categories. The four categories are administrative costs, compliance costs, transfers, and inefficiency.

Administrative Costs. Here I include the costs incurred for the staff, supplies, studies, and consultants' reports needed to write, manage, publish, and police regulations. Essentially, these costs cover the architectural and housekeeping work that goes into developing and operating the regulatory system. (For this discussion, I limit administrative costs to those incurred by the federal government, but costs of this character are also incurred by private firms and other units on which regulations impinge.) Estimates of the government-financed administrative costs can be obtained from the government budget (with appropriate attention to cost allocation problems).

Compliance Costs. This category is comprised of expenditures attributable to regulation incurred by firms (and other units) covered or affected by the regulations. Costs in this class include those incurred to analyze possible approaches and to shape proposed standards, those necessary to meet the specifications established by the regulations, and those necessary to develop data and maintain records demonstrating compliance and to defend the compliance strategy against legal assault. For that component of compliance costs that consists of housekeeping functions that would not be carried out in the absence of regulation, cost estimates can be developed in a relatively straightforward fashion from the accounting records of the firms involved (with appropriate cost allocation).

But for other components of compliance costs, estimation is often more complicated. Consider—as a model—the simplest case where, in order to meet a technical standard limiting effluent discharges or exposure levels, it is necessary to develop, install, operate, and maintain a specific additional piece of equipment. Here the costs attributable to regulation can be traced to specific entries in the accounting records of the units making the expenditures necessary to achieve the standard. Situations are rarely this simple.

In more complex cases, the need for exercising judgment becomes more obvious, and additional uncertainty is accordingly introduced into cost estimates. The appropriate reference point for calculating costs attributable to regulation is readily identified when meeting a standard requires discrete and separate additional equipment or practices. It is less easily identified when a new plant or production process is designed, constructed, and placed into operation. If compliance requires changes more complex than the simple model—if it requires change that is incorporated instead as an integral part of the process itself (or even perhaps substitution of a quite different process)—the costs must be allocated somehow between production and pollution abatement. And, as is well known by students of public utility regulation, the allocation of joint costs —to, for example, long distance transmission, network switching, and local telephone service —is inevitably somewhat arbitrary.

A different complication arises when regulatory standards imposed on one firm can be met only by using inputs with different (and more costly) specifications purchased from another firm. This component of the costs of meeting a standard could in principle be estimated either from the increase in input prices for the user firm or the increased cost to the producing firm. (Including both would, of course, be double counting, and the methodology of the Business Roundtable study was designed to avoid this.) It should be noted,

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however, that while the user firm may be aware that the more costly input specifications arise from a regulatory requirement, it may not have access to the producing firm's accounting records for making a cost estimate. Conversely, while the input-producing firm may be in a position to estimate the increased production costs, it may be unaware that they are a result of a regulatory requirement for the user firm. Little imagination is required to envision the difficulties in tracing all the costs incurred in this way as the number of stages in the production process is extended and the number of firms increased.

Unlike the administrative costs incurred by government, which are financed by taxes, compliance costs are financed largely through higher prices to consumers who purchase the relevant goods and services. The basic data for estimates of these costs are accordingly contained in the accounting records of the firms affected. Although the relevant costs cannot ordinarily be estimated by methods as simple as adding up an appropriate selection of vouchers, it is nevertheless possible to develop reasonable estimates of compliance costs by using a methodology such as that employed in the Business Roundtable study.

Transfers. The costs in this category do not really represent *economic* costs. That is, they do not by themselves involve the use of resources that could otherwise be devoted to other ends. Consider—as an example of a transfer-type cost—the effects of minimum wage regulation. An increase in the legal minimum rate obviously results in an increase in labor costs. (As in the instances discussed earlier, of course, the appropriate reference point for comparison becomes difficult to establish precisely with the passage of time.) The increase in labor costs, however, does not involve additional resource usage, but instead higher wage incomes—at least for those able to obtain jobs at the higher wage levels.

It should be noted that most regulations give rise to costs in more than one of the four categories I have outlined and involve a transfer component that can be distinguished from the costs borne by the society as a whole. The first point is illustrated by the minimum wage example: according to the available evidence, higher minimum wages result in lower employment than would otherwise be realized, with the job losses representing a separate and additional cost of regulation that would not, of course, be included in costs experienced by firms. The second point may be illustrated by standards limiting exposure to cotton dust, in which the benefits accrue mainly to workers in the industry and the costs are borne by the much broader class of consumers of cotton products. As another example, abatement of pollution for a particular geographic area or industry confers benefits on groups that are in general quite different from those bearing the costs. In many instances these transfer components may be compensated for by subsequent market adjustments; for example, when jobs are made safer, the wages necessary to attract workers may be lower.

As this discussion shows, the higher costs (and the correspondingly higher prices to consumers) that result from regulation are not always accompanied by an equivalent reduction in resources available for other uses. Thus, the costs of regulation that appear as transfers tend to raise prices rather than to use up additional scarce resources.

It is extremely important to distinguish the costs in the transfer category from the costs that arise through a process that in some respects may seem similar. For example, the costs of designing, building, operating, and maintaining a piece of pollution abatement or safety equipment show up as jobs, incomes, and profits generated by the firms that build such equipment, and as jobs and incomes for those that operate and maintain it. It is thus sometimes said that more jobs and income are gained as a result of regulatory programs than are lost as a result of failures or reduced production among the regulated firms. The basic error in regarding these designing, building, operating, and maintaining costs as a transfer—or even a net gain—is that, unlike transfers, they represent real resource use. That is, the jobs involved in the firms making the pollution abatement or safety equipment *are* the real resources represented by the cost estimates, so that diverting these resources to this use means a *net reduction* in resources available for other uses. The higher costs to consumers that result do not represent simply a transfer of income.

Regulatory costs in the transfer category may not be very important for the particular

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programs analyzed in the Business Roundtable study. Other studies of regulatory costs, in the transportation area particularly, suggest that transfers could be an important factor; higher costs to shippers may in part be reflected by higher wages in the regulated sector and in the values of operating rights. In any case, costs in this class are not readily captured by a cost-estimating methodology that relies on accounting records. Instead, market behavioral responses must be estimated using appropriate models and data. Costs that should be regarded as transfers could inadvertently be captured by the Business Roundtable methodology, however, and included with other (true economic) costs. For example, under ERISA regulation, costs of increasing plan contributions to enhance benefits to participants (some $40 million of the $61 million in ERISA costs estimated in the study) should be regarded as a transfer, and thus different in concept and effect from most other costs estimated in the study.

Inefficiency Costs. This fourth class of costs represents a disparate collection, familiar to economists as "deadweight losses." Regulation often restricts the range of permissible prices, practices, or processes, and these legal restrictions affect the pattern in which resources are used. If these restrictions could be modified to bring about a redeployment of the resources so as to produce a higher total value of output (including the value of things not traditionally traded in markets such as improved air quality), regulations can be viewed as imposing net costs. These costs would be "deadweight losses" that result from producing the wrong mix of output, producing with the wrong mix of inputs, or both. The mix is "wrong" only because, *with the same basic resources*, more could be produced of what is valued most. That is why the consequences of the "wrong" mixes can be regarded as costs.

Some examples may be useful to illustrate inefficiency costs. Suppose, for example, that shipping rates established by regulation result in freight moving by railroads that could have been hauled more cheaply by truck (or vice versa). Total resource costs of hauling the freight would be reduced if different prices prevailed—or, alternatively, more freight could be moved without additional resource usage. As another example, consider a regulation requiring such stringent documentation of substantive advertising claims that advertisers shift instead toward messages that provide little substantive information. In this case, costs to the advertiser may even be reduced, though the interests of potential customers would have been better served if the shift had not occurred.

These examples illustrate inefficiency at a point in time, but investment decisions, with implications for the future, can also be affected by regulation. Suppose, for example, that requirements for demonstrating the safety of new pesticides are made so severe and thus so expensive that new and specialized substances are no longer developed. The result could be a choice between using older and more dangerous pesticides or suffering severe crop damage. Consider, as another example, the effects of a regulation that sets up an emission standard based on what could be met by using a specific piece of pollution abatement equipment. There would be no reward for doing better than required by the standard. Moreover, there would be little point in developing a lower-cost control method if its performance fell just short of the standard. In other words, despite the possibility of substantial cost savings for essentially comparable performance, an alternative approach might not meet with regulatory approval. Thus research, development, and innovation might, as a consequence of the incentives and constraints in a rigid regulatory approach, be channelled in directions that would not produce the highest pay-off to society.

One important point illustrated by these examples is that costs to society cannot be identified simply by scrutinizing company accounting records. In some cases, the costs to society are the result of too little expenditure by firms for investments or products or services that would in fact be more valuable to society than some of those on which the resources are expended. In most instances, costs of these kinds can be identified and estimated only by the use of complex (but nevertheless still oversimplified) models of the processes and behavioral responses involved, and by assembling extensive data so that the model can be applied. While costs arising from inefficiency are more subtle to grasp and more difficult to measure than the other types of costs, they are in a sense the most serious because they represent pure waste of resources.

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. . . costs arising from inefficiency . . . are in a sense the most serious because they represent pure waste of resources.

A second point with potentially great long-term significance is that, while the size of regulatory costs is obviously important, the *manner* in which these costs are incurred may be even more important. Current regulatory approaches often take the form of specific equipment requirements based on engineering design studies or pilot projects, which are in turn based on price projections that may prove to be unrealistic and technology that is either currently available or on the immediate horizon. As a result, incentives for improvements in performance beyond that specified by the standards are limited or absent and the attractiveness of maintaining static technology enhanced (because this technology, in practice, becomes the definition of meeting regulatory requirements). Thus regulatory requirements that impose the same current (or discounted) costs can have different implications for productivity and output in the future.

Summary

The estimates of costs of government regulation developed in the Business Roundtable study provide useful information on ways in which regulatory costs are incurred and on their magnitude. The significance of this contribution is in part attributable to the carefully detailed methodology employed and to the use of the financial and accounting records of the firms affected. But in a number of ways the information is limited in its scope.

The most obvious limitations are in the number of regulatory programs covered, the number and size of the firms involved, and the fact that only federal regulations were studied. Thus only six regulatory areas (selected in part on the basis of the magnitude of their impact) were considered, and certain programs in these areas were excluded (such as the antitrust activities of the FTC). The firms involved are large, and while a considerable share of the nation's economic activity is covered and a reasonable diversity of industries represented, generalization from these estimates to the economy as a whole (as the study notes) cannot be made. In addition, of course, nonprofit organizations such as hospitals and schools as well as state and local governmental units are also affected by federal regulation. Limiting the study to only *federal* regulation is reasonable, but it does have the effect, for example, of excluding all costs of pollution abatement for automobiles sold in California because state standards, being more stringent than those of the federal government, preempt the federal standards.

More broadly, the methodology underlying the study cannot be used to identify and estimate certain types of regulatory costs likely to have a significant impact on the economy, as is acknowledged in the study. The costs that are estimated are only those in the second category —compliance costs—of the four that I have discussed. Costs in the first category—administrative costs—can, of course, be estimated from government budget sources. But costs in the other two categories—transfers and inefficiency —are another matter. Estimates of these cannot be made by analysis using only the accounting records of the units affected, but require instead more complex and sophisticated methods of economic analysis.

. . . the Business Roundtable study should be viewed as sketching out a limited, though significant, portion of the more complex overall picture. . . .

There is evidence that these more difficult-to-measure types of cost are quantitatively important. Empirical studies of the effects of transportation regulation, for example, have produced evidence of significant transfer and inefficiency costs. Studies of drug development and innovation and of water pollution abatement have produced evidence of adverse effects through inefficiency in meeting regulatory goals. The information on regulatory costs developed by the methods of the Business Roundtable study should be viewed as sketching out a limited, though significant, portion of the more complex overall picture of the costs of regulation. ■

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Litigation, Bargaining, and Regulation

Peter H. Schuck

In the United States, the link between the regulatory system and the adversary process is a close one, reflecting not only their common legal parentage but the ethos of contentiousness so deeply embedded in our social processes and institutions. That ethos, that chronic fractiousness, characterizes our journalism, our dissenting religious tradition, our arts and literature, our political institutions, and our competitive economic system. So ubiquitous is it that Lionel Trilling defined ours as the "adversary culture."

Indeed, our adversary processes are far more highly developed than those of societies built on similar legal foundations. In England, for example, the number of lawyers per capita is but a fraction of what it is here, mirroring (and perhaps contributing to) the dearth of litigation and of public law in the English system. Such a difference strongly suggests that adversary processes serve important functions in our society. First, they recognize and give active voice to our extraordinary diversity of political, economic, social and other interests. Second, they provide each participant with a strong incentive to adduce facts, assert values, controvert the facts and values of others, and advance his or her own view of the public interest. Because those affected are most likely to know what information and values are relevant to the decision in question, the adversary process sharpens and gives added content to the issues requiring decision, while stimulating innovative approaches and solutions. Third, adversary processes, by providing a systematic channel for dissent and criticism, serve as solvents for encrustations of state power, privilege, and ideological orthodoxy. Finally, they invite participation in the decision-making process by those who are affected—participation that is valuable in a democratic society quite apart from its potential contribution to the quality of the decisions. It is not surprising, then, that adversary processes enjoy considerable constitutional, statutory, and judicial protection; in a liberal society in which there is no received or even widely shared notion of truth, they are simply indispensable for resolving sharply conflicting interests.

The adversary process manifests itself in many forms. Professor Lon Fuller described a spectrum of forms ranging from pure adjudication by a formal and independent tribunal to pure bargaining between opposed interests. Each form of the adversary process can be located on this spectrum according to the extent to which it employs a logical-rational process. Pure adjudication possesses this attribute to the fullest degree (at least in theory) by virtue of the norms that govern it—such as a commitment to precedent, logical deduction from general principles, decision by an objective decision-maker on the basis of a well-defined record, and the like. Pure bargaining between in-

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terests, however, is not a rational process at all except in the narrow sense that it reflects the calculated interests of its participants. Moving along the spectrum from adjudication to bargaining, one can identify numerous mixed forms: arbitration, arbitration in which the parties select some of the arbitrators, informal rulemaking under the Administrative Procedure Act (APA) in which reasoned arguments are presented to an independent decision-maker bound by only the most minimal constraints (such as the obligation to state reasons for the decision), bargaining structured by legal requirements (as under the Wagner Act), mediation, and other hybrids.

My argument may be simply stated. While both the adjudicatory and the bargaining forms of adversary process possess distinct advantages and disadvantages, I believe that our regulatory system has come to rely excessively upon the adjudicatory form to the relative neglect of direct bargaining between interests. Most efforts to reform the administrative process have amounted to tinkering with what remain essentially adjudicatory modes, and have in some cases actually magnified, rather than reduced, the inherent limitations of those forms. While direct bargaining between affected interests will, for a variety of reasons, play only a limited role in the regulatory process, that role might be expanded to a modest degree without abandoning the considerable advantages of more formal procedures.

Regulation and the Litigation Model

While many procedural innovations—broadened public rights of participation, governmental subsidy for participants, judicial insistence upon open and reviewable regulatory activities—have been designed to enhance the *scope* of the adversary process in regulatory proceedings, there has been relatively little experimentation with new adversary *forms*. Virtually all regulatory processes—policy development, standard-setting, licensing, application of general rules to particular situations, and enforcement—are conducted through procedures that cluster near the adjudicatory end of the spectrum, and most innovations in administrative procedure have been drawn with magnetic force toward that same pole. Even "informal rulemaking," originally intended as a flexible, discretionary, legislative-type process, has been relentlessly judicialized, formalized, and rationalized into something quite different.

Virtually all regulatory processes . . . cluster near the adjudicatory end of the spectrum. . . . Even "informal rulemaking" . . . has been relentlessly judicialized, formalized, and rationalized. . . .

This development can be seen in the spate of "hybrid" rulemaking procedures—requiring public hearings before impartial decision-makers, oral testimony, cross-examination of witnesses, judicial review on the basis of a well-defined record, reasoned and articulated decisions, and the like—that Congress has written into an increasing number of regulatory statutes. It can also be seen in the less visible, more incremental, but equally dramatic transformation of informal rulemaking through judicial interpretation, a trend that had proceeded so far that the Supreme Court felt compelled last year (in the *Vermont Yankee* case) to employ unusually strident language to repudiate it. Yet the impulse on the part of the lower courts to "judicialize" informal proceedings appears to remain irresistible; indeed, as Antonin Scalia has argued, the most important of those courts (the District of Columbia Circuit) blithely continues on this path even now, undeterred by the Supreme Court's caustic admonitions. Perhaps the clearest indication of the strength of this impulse and of its political support is that the Carter administration's regulatory reform proposals would take only a few modest steps away from the adjudicatory pole (for example, by expanding the existing discretion of hearing officers to dispense with cross-examination), while at the same time taking a few other steps back toward it (for example, by importing separation-of-function principles into rulemaking). In sum they would not appreciably disturb this trend towards the judicialization of regulatory procedures.

The regulatory agencies, then, have relied heavily upon what we shall call the litigation model, in which adverse interests present their arguments to an independent tribunal for decision—to the exclusion of what we shall call

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the bargaining model, in which they advance their arguments directly (or through an intermediary) to each other. (Much bargaining already occurs in the regulatory process, of course, but it is largely negotiation between the decision-maker and a party or parties, rather than between the parties themselves). The appeal of the litigation model is easy to understand, given its formidable strengths. These strengths—moral legitimacy, social acceptability, and reliance upon precedent—derive from a formal rationality dictating that decisions be deduced from general principles free of "irrational" decision criteria extraneous to those principles and that judgment be rendered in favor of one party and against the other.

Yet just as surely, the litigation model has important shortcomings. For example, the decision-maker is presented with a choice—but usually only between two outcomes, each of which pushes against the extreme limits of what each party thinks the decision-maker might be persuaded to adopt. Thus, very few of the many possible outcomes lying somewhere in between are systematically considered. To be sure, the parties are always free—and may even be encouraged—to negotiate a settlement falling somewhere within that vast field of possibilities. Yet the prospect of complete victory is alluring and tends to discourage settlement until the final stages of litigation. Moreover, the law's preoccupation with assigning fault, liability, guilt, or rights to one party or the other —but not both—further entrenches obstacles to negotiated settlement. Finally, the decision will divide the adverse parties into a "winner" and a "loser." The latter will tend to have little commitment to the "rightness" of that decision, and will often seek exoneration through judicial review or will obstruct or delay implementation of the decision.

In addition, the nature of the litigative process—the procedures, the rules of evidence, the criteria of relevance, and so on—and the substance of the ultimate decision itself are controlled by someone other than the parties affected. While this reinforces certain fundamental values that legitimize the litigation model (such as the objectivity of the tribunal, the exclusion of extraneous influences, and the paramount importance of rationality in the decision process), it sacrifices certain other values. Thus, the procedural and evidentiary "rules of the game" tend to grow more complex and technical over time. As they almost become ends in themselves, the game itself tends to grow ever more expensive, protracted, and preoccupied with form, technique, and tactics.

More important, the formality of the process limits its suitability for pragmatic approaches to problem-solving. Rather than speaking to one another, the parties speak to the decision-maker. Rather than seeking common ground, they try to induce the decision-maker to allocate blame. Rather than seeking new formulations around which a compromise might be shaped, they wrap themselves in established precedents with which the decision-maker will be more familiar and comfortable. Rather than adducing whatever facts or values they deem relevant to the issues that divide them, they confine themselves to those that the decision-maker is thought to deem relevant in some technical sense. Rather than maximizing the flow of information that would bear upon potential compromise solutions, they screen it out, greatly simplify it, or otherwise distort it in order to conform its contours to the Procrustean bed of litigation formalities.

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In this way, the decision-maker remains remote from the ambiguities and subtleties of the problem at issue; while the parties possess a "feel" for the problem that could contribute to its solution, they cannot easily communicate that "feel" to the decision-maker, who knows the problem only through a highly stylized evidentiary presentation or, worse, a "cold" written record. In addition, the decision-maker is constrained to treat facts as unequivocally true and legal rules as unequivocally applicable when these are actually contingent or uncertain, just as he or she is ordinarily constrained to find for one party or the other even when the fault or loss ought properly to be shared.

Finally, the litigation model's emphasis on reasoned argumentation and logical deductions

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from first principles makes it inappropriate for resolving certain kinds of regulatory issues. Even judges do not simply decide by logical deduction from well-defined premises but inevitably engage in a process containing many elements of subjective choice. This is not necessarily regrettable, but it does tend to dilute some of litigation's advantages over less "rational" decision modes. Many regulatory problems are what Fuller characterized as polycentric. Polycentric problems can be solved only by taking account of numerous interdependent and highly variable factors which oblige the decision-maker to manage a kind of cybernetic process involving tentative probe, feedback, adjustment, and reconciliation. (A common example is the allocation of limited supplies of natural gas among a number of different but economically interdependent end uses.) Such problems ordinarily involve multiple criteria, and can be solved only by applying a number of standards whose relative weightings and orderings are sufficiently indeterminate as to imply no particular solution. Such a problem (for example, the selection of a water quality standard) requires the exercise of substantial discretion rather than the application of preexisting decision rules, and its solution will often require interaction between the decision-maker and others—interaction that would be inconsistent with traditional norms of litigation. A vast number of regulatory proceedings —and certainly the most important—focus on polycentric problems and require the application of multiple criteria, even though such problems do commonly generate some questions suitable for adjudication—whether all relevant factors were considered, whether prescribed procedures were observed, and the like.

Adjustments to the Litigation Model

Congress, the agencies, and the courts have fashioned a number of innovations in an effort to overcome the inherent limitations of the litigation model. Each, however, has fallen short. The most important of these, the informal rulemaking process, suffers from some (though not all) of the same defects that afflict formal adjudication—chiefly the fact that parties play formalized roles, tend to adopt fixed (and extreme) positions, and communicate with the decision-maker rather than each other. (The fact that the decision-maker—the agency—is often a party in interest may distort communications even further.) As we have noted, informal rulemaking has become progressively judicialized by Congress and the courts; indeed, recent controversy over presidential intervention in such proceedings threatens to strengthen that trend.

More recently, the courts have elaborated another important variant on the litigation model—what Professor Abram Chayes has described as public law litigation—but far from surmounting litigation's shortcomings, this variant exacerbates some of them. Much public law litigation is directed at the conduct of states in directly administering institutions, such as hospitals, schools, and prisons. But much of it—perhaps an increasing proportion —is directed at federal and state agencies in their exercise of regulatory authority over complex state and private sector activities. Examples of such litigation include a suit to compel the Department of Health, Education, and Welfare to bring about desegregation of higher education in the southern and border states by withholding funds, and a suit to compel the Department of Labor to use its authority to reform the activities of state employment services.

Obviously, public law litigation has much in common with traditional litigation; some scholars even contend that the new variant is novel only in the substantive rights it adjudicates. Nevertheless, it does attempt to broaden the range of interests represented in the case, employ innovative fact-finding processes, fashion remedies directed at institutional reforms for the future rather than merely resolving past disputes, and legitimize a more intrusive judicial role in the dispute.

Despite the creative transmutation of the litigation model to embrace the forms and functions of public law litigation, however, the model's capacities for reshaping litigation without altering its essential qualities may well be approaching its outer boundaries. First, the number of polycentric problems for which society demands a governmental solution appears to be increasing rapidly. Even judicial adjustments, such as class action procedures and court orders mandating institutional changes, cannot keep pace indefinitely with the growth in the demands being placed upon the courts to resolve such issues. Heightened efforts to

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satisfy these demands through litigation must *at some point* undermine the pretense that it is adjudication that the courts are engaged in, and must inevitably produce more simplistic decisions.

Second, such adaptations, far-reaching as they are, fail to rectify some of the fundamental limitations of the traditional model. Thus, despite its best efforts, public law litigation may fail to include important interests. In litigation against state mental hospital administrators, for example, the interests of taxpayers and of recipients of other tax-supported services (like health care for the elderly) may not be represented. Some of the regulatory problems with which public law litigation attempts to deal—the location of public housing, the structure of the oil industry, the relationship between traditionally white and traditionally black colleges in the southern and border states—magnify the shortcomings of the litigative fact-finding process, even as (or perhaps especially as) it is augmented by a more active court involvement and a more promiscuous use of social science theory and data. The kinds of issues involved in such litigation possess an ideological dimension that strengthens the tendency for litigation to polarize and harden positions. Moreover, such issues are often so specialized (for example, higher education curriculum or mental health administration) that the decisionmaker can only deal with them in a simplistic fashion. In addition, the absence in these cases of any single standard or criterion by which to resolve the problems (except by doing violence to their complexity) renders adjudication increasingly an exercise in administrative discretion and subjective judgment. This undermines the adjudicator's distinctive advantage—the claim to be administering rational justice.

Third, public law litigation vastly complicates the problem of implementing court decrees. Not only are the issues involved in such litigation often polycentric; they are also problems for which no satisfactory solutions may be at hand. Above a minimal threshold, for example, no one really knows how to rehabilitate criminal offenders, or what constitutes a "proper" or "effective" course of treatment for the institutionalized mentally ill, or how to ensure that deinstitutionalization of such persons will not entail serious risks to their well-being. Even if such knowledge existed, factors over which adjudicators have little or no control inevitably constrain and distort execution of the decree.

Finally, public law litigation greatly compounds a problem that conventional litigation, because of its more modest ambitions, largely avoids: the limitations of substantive legal rules as instruments for easing complex social conflicts and interactions. As these conflicts and interactions grow in number and intensity, legal rules and formal centralized decision processes lose their capacity to accommodate them effectively, while generating new and less manageable conflicts. In such cases, public law litigation may well simply reinforce the natural inclination of legislators to pass the buck to the courts. Even legislators truly desiring higher standards in mental hospitals, schools, and prisons may find it considerably easier to support increased appropriations demanded by a court order than to assume the political responsibility for initiating the necessary tax increases (or reductions in other more popular programs).

The litigation model, then, shows significant and systematic limitations as a way of resolving regulatory issues—limitations that are only partially overcome (and are in some respects exacerbated) by the informal rulemaking and public law litigation variants. These limitations argue strongly for consideration of procedural devices less prone to those deficiencies.

Regulation and the Bargaining Model

The processes of mutual accommodation—bargaining, reciprocity, mediation, contract, log-rolling, deference, voluntary cooperation—are unquestionably the predominant modes of human interaction and dispute resolution in our (or perhaps any) society. However described, these particular orderings of adversary relationships have one characteristic feature: they all entail a voluntary exchange between two or more persons which each believes will render him better off than he was before (or would be in the absence of) the exchange.

Every liberal society must protect the integrity of bargaining processes. Indeed, unless it is prepared to invest enormous resources to administer centralized social controls, society must nurture and extend those processes. The reasons are not hard to find. The bargaining

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model exemplifies the virtues of all adversary processes: it encourages diversity, stimulates the parties to develop relevant information about facts and values, provides a counterweight to concentrations of power, and advances participation by those the decisions affect. Moreover, it secures these advantages without incurring the shortcomings of the litigation model. Thus, good faith bargaining often unearths solutions lying between those extreme positions that would be asserted by the parties in litigation. Bargaining tends to expose the true intensities of the participants' preferences, while litigation tends to exaggerate those intensities. Bargaining stimulates the flow of information *between* parties (information relevant to their preferences, even if not to the applicable legal rules), while litigation constricts inter-party communication (and takes a narrow view of relevance). For these reasons, bargaining can help participants to develop a better appreciation of the perspectives of their adversaries than litigation can, an appreciation that may reduce hostility, soften positions previously taken, and suggest solutions that had escaped notice. In addition, because bargaining is a process controlled by the parties themselves, any solution is likely to reflect a more sensitive "feel" for the problem that engendered it; litigation exhibits the opposite tendency. And because a bargained solution is essentially voluntary and emerges from a process that helps build consensus, it is more likely to generate support by both parties for its implementation; litigation—particularly the public law variety—can pose awesome problems of implementation, in part from the continuing intransigence of a losing party.

Finally, a bargained solution depends for its legitimacy not upon its objective rationality, inherent justice, or the moral capital of the institution that fashioned it, but upon the simple fact that it was reached by consent of the parties affected. The importance of that criterion is rooted in the fact that the problems around which many (and perhaps the most important) social conflicts turn have no "right" or "wrong" answer in any moral or even technical sense. Such conflicts are best resolved through a mechanism based not upon principle but upon pragmatic accommodation and adjustment. In contrast, the litigation model assumes that the problems with which it deals have "right" and "wrong" solutions that ordinarily correspond to the positions of the prevailing and losing parties; indeed, its essential nature and strength depend upon this premise.

These formidable advantages of bargaining over adjudicatory-type processes are, of course, not without their own costs. As the number of parties increases, the difficulties in reaching a bargained solution also increase. Since the bargained solution tends to reflect the initial bargaining power of the parties, it may be unacceptable from a moral or social standpoint. Bargaining can only succeed if the parties perceive that they have a stake in achieving a negotiated solution. A party can easily subvert the process by delay (or otherwise) if it has an incentive to do so and if no sanctions exist to dissuade it. If a bargained solution is to command respect and legitimacy, all those with a significant stake in the outcome must be represented, yet diffuse interests may not be well-organized enough to participate. Finally, the bargaining process cannot generally be conducted efficiently in public view, yet secrecy in the resolution of public issues offends widely held democratic beliefs.

The bargaining model exemplifies the virtues of all adversary processes. . . . Moreover, it secures these advantages without incurring the shortcomings of the litigation model.

These limitations, however, need not be fatal to a broader use of bargaining in the regulatory process. First, the considerable disadvantages of litigative processes justify serious consideration not only of perfect alternatives with widespread applicability, but also of imperfect alternatives with limited applicability. Even marginal improvements simply cannot be sneered at. Second, some of the bargaining model's shortcomings are at least equally characteristic of the litigation model. Thus, the complexity introduced by having more than two parties in interest is a disadvantage that an adjudicator avoids only by pretending that there are only two. Parties to litigation often have considerable incentives (and opportunities) to delay and perhaps moot a decision. And it is highly unlikely that all relevant in-

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terests will be represented in litigation. Third, some of these shortcomings constitute a greater problem for certain regulatory activities (say, standard-setting) than for others (say, policy development or the application of general rules to specific situations). Finally, as noted below, it may be possible to devise hybrid forms that combine the advantages of both the litigation and bargaining models, while minimizing their defects.

Some Applications of Bargaining in the Regulatory Process

Regulators, of course, already engage in much negotiation with regulated (and other affected) interests. The inescapably political environment of regulation and the costs and limitation of adjudicatory and near-adjudicatory procedures ensure that this kind of bargaining will continue. But it is typically conducted between the agency and another party to the proceeding rather than between the parties other than the agency. This reduces bargaining's characteristic virtue—the advantage of face-to-face exchanges between the parties primarily at interest. Improvement over the status quo may be found in stimulating more fruitful dialogues between those parties, rather than in reinforcing the litigative nature of existing regulatory processes.

The usefulness of bargaining in the regulatory process depends to a considerable extent on the nature of the regulatory activity in question. Let us consider potential uses of bargaining in four activities—policy development, standard-setting, enforcement, and the application of general rules to specific cases.

Policy Development. The experience of the National Coal Policy Project suggests that even in extremely controversial and politically charged policy areas, dispute over policy alternatives can be considerably narrowed and important consensus achieved through negotiation. The project brought together industrialists and environmental activists in an effort to address important coal-related environmental and energy policy issues. Its task forces, composed of members nominated by the environmental and industrial caucuses, engaged in extended discussions to clarify positions and reach such agreement as might be possible. The discussions culminated in a striking degree of consensus on the policy-relevant facts and in a series of more than 200 recommendations organized around questions of mining, transportation, air pollution, fuel utilization and conservation, energy pricing, and emission charges. While some of the recommendations were general and highly qualified, others (for example, support for full marginal cost pricing of energy, opposition to cross-subsidization, and location of major coal-burning power plants in areas where the energy is to be distributed rather than in remote areas) were quite specific and potentially far-reaching. Participants on both sides are now engaged in efforts to persuade decision-makers to implement the recommendations, devise new approaches to those issues upon which agreement could not be reached, and extend the discussions to other interests (such as labor unions and consumer groups) whose failure to participate appears to constitute the project's chief limitation.

Standard-setting. At first blush, the development of specific regulatory standards would appear to be particularly ill-suited to the use of bargaining, given the multiplicity of interests involved and the obligation of agencies to ensure that regulation meets statutory requirements, rather than simply reflecting a consensus.

Nevertheless, there may well be an appropriate (if modest) place for bargaining in standard-setting, though it will require that the regulatory agency itself play a new and delicate role in the process. The agency would have to preside over what might be called "structured bargaining," in which it would prescribe certain policy parameters within which the bargaining would be conducted and attempt to ensure that all legitimate interests had an opportunity to participate. It would be careful not to intrude into the dynamics of the bargaining process itself (at least not in the first instance), attempting only to facilitate a bargained consensus among the interests within the parameters previously set. But it would not be bound by that consensus, remaining free (consistent with its governing statute) to impose a different solution. In this way, it might realize the main advantages of both the litigation model and the bargaining model, while minimizing the major disadvantages of both.

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The phenomenon of collective bargaining conducted under the Wagner Act and the watchful eye of the National Labor Relations Board is an alluring—but inapt—model for such structured bargaining. In the case of collective bargaining, Congress has taken the view that, except in unusual circumstances, the clash of management and labor suffices to protect the public interest. With most regulatory programs, however, Congress has clearly proceeded from a contrary premise, giving the agency responsibility for the formulation of substantive regulatory policy. A more useful analogy is the "offeror" procedure under the Consumer Product Safety Act. The act authorizes the Consumer Product Safety Commission (CPSC) to contract with an outside organization (the "offeror") to develop a product safety standard that the CPSC may wish to adopt as a mandatory standard. The offeror manages the development process and must systematically involve a variety of interested groups, including consumers, small business, retailers, and so on; indeed, the CPSC has sometimes subsidized the participation by such interests where they cannot afford it themselves. The CPSC may accept, reject, or modify the standard developed by the offeror.

Such a regulatory procedure, at least in theory, encourages informal, face-to-face, problem-solving negotiation between the affected interests, under the auspices of a public body that retains final decision-making authority. The offeror program has been much criticized, and the CPSC has begun to move away from relying on it—a movement accelerated by Congress's recent expansion of the commission's authority to develop standards in-house. To some extent, this experience reflects the fact that the commission had played a passive role in the process, providing little guidance, direction, or assistance of either a technical or a policy nature to the offeror. Recently, however, it decided to play a more active role—providing more "front-end" information and analysis, narrowing the number and scope of the hazards to be addressed, suggesting some alternative solutions, and involving its staff more in the process—with far better results. (It must be admitted, however, that the standard in question—for Christmas tree lights—may not have been typical.) Moreover, as the commission begins to encounter problems in developing standards in-house, the imperfections of the offeror process may loom somewhat smaller by comparison. Indeed, such reasoning underlies a soon-to-be-issued Office of Management and Budget circular that will call upon government agencies to rely more upon privately negotiated ("consensus") standards and to participate more in their development.

Enforcement. Clearly, a great deal of bargaining occurs between regulatory agencies and those upon whom they intend to impose sanctions; such bargaining is ordinarily designed to encourage voluntary compliance and reduce the need for formal procedures. Rarely, if ever, does the agency employ its authority to convoke direct negotiations between the parties primarily at interest—the "violator" and the "victim"—in an effort to resolve the dispute to the mutual satisfaction of all. Given the ambiguity of many regulatory requirements, the consequent ease with which good faith misunderstandings may arise between regulated interests and the public, and the often marginal policy importance of such disputes, it would appear that mediation—that is, bargaining through the medium of a neutral third party—might prove useful in resolving such cases.

Regulation under the civil rights laws seems an apt candidate for expanding the use of negotiation as an adjunct to the enforcement process, since good faith disputes over the meaning of those laws are legion, and negotiation could lead to satisfactory resolutions.

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In fact, efforts to conciliate civil rights complaints arising under the jurisdiction of the Equal Employment Opportunity Commission are already under way; the procedure is flawed, however, by the fact that EEOC staff members, who may not be disinterested, performed the mediation. Under the Age Discrimination Act, on the other hand, mediation will be performed by an independent body, the Federal Mediation and Conciliation Service. The complainant, of

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course, retains the right to seek enforcement in the event that mediation fails.

Applying General Rules to Specific Cases. Long before any concrete issue of enforcement arises, there will often be questions of the extent to which a regulation applies to a particular activity. A dispute may exist, for example, as to whether the proposed siting of an electric utility violates environmental laws, whether a proposed housing development complies with civil rights restrictions against racial concentration, or whether a bank's past lending practices offend laws prohibiting "redlining" of neighborhoods. In each of these cases (and especially where the controversial action has not been taken), there may well be incentives on all sides to resolve the issue without resorting to the regulatory process. Such incentives may include a desire to avoid alienating the community, the financial costs of a building project's becoming bogged down in litigation and wrangling, uncertainties if decisions are to be made by regulatory and judicial forums, and the like.

Perhaps as a consequence, there has been considerable experimenting with mediation of community disputes, especially in the environmental area. Indeed, environmental mediation has acquired the hallmarks of an idea whose time is coming—a growing body of case studies of successful mediations, foundation support for some pilot efforts (for example, Environmental Mediation International), a newsletter, an academic base (at the University of Washington), and even its own government agencies (the Office of Dispute Settlement in the New Jersey Department of the Public Advocate, for example). In practice, mediation of community disputes entails a number of separate activities: "conflict anticipation" (before mistrust has developed and significant costs have been incurred), "data mediation" (to develop consensus on the basic factual issues underlying the dispute), "conflict assessment" (the development by the mediator of recommendations for breaking a deadlock), and other but more traditional mediation processes.

In November 1978, the Council on Environmental Quality adopted new regulations requiring that the preparation of an environmental impact statement be preceded by a "scoping" process in which the agency responsible for the statement convenes interested parties to determine, through negotiation, the scope of the issues to be addressed. One can imagine this new procedure evolving into structured bargaining between these interests on disputed substantive issues—of course, under the aegis and prodding of the agency.

Conclusion

A variety of factors—growing public suspicion of the private sector, risk aversion on the part of health and safety regulators, the widespread conviction that the public interest can be protected only by government decision, and a recognition of the shortcomings of bargaining between interests—ensures that direct bargaining between interests will probably never play a major role in the development of regulatory policy and regulatory decisions. Nevertheless, an increased role may be desirable. Innovation in this area is not confined to a choice between the litigation and the bargaining models. Hybrids such as structured bargaining can be fashioned to conform to the needs of particular regimes and to draw upon the strengths (and minimize the weaknesses) of each model. Most important, to the extent that Congress delegates polycentric, multiple criteria problems to regulatory agencies (and, for better or for worse, such delegations are likely to continue), some form of structured bargaining appears to comprise an essential element of any problem-solving mechanism. Such problems are at root neither technical nor legal but political—that is to say, they are problems of social choice in a world of ever more limited resources. In such a world, bargaining may do for us what litigation and law increasingly cannot: it may nourish those impulses toward integration, accommodation, reconciliation, and mutuality of interests which an adversary society tends to stifle, but without which no society can effectively discharge its business. ■

. . . direct bargaining between interests will probably never play a major role in the development of regulatory policy and regulatory decisions. Nevertheless, an increased role may be desirable.

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ANTITRUST COMES TO CITY HALL

Joe Sims

NOT TOO LONG AGO, the city of Lafayette, Louisiana, was charged with violating federal antitrust law because of the way it operated a municipal electric company. The city argued that, as a creature of the state of Louisiana, it was immune from federal antitrust prosecution. But the Supreme Court disagreed, and sent the case back to the district court for trial. This may be one of the most significant antitrust decisions of recent years.

City of Lafayette v. *Louisiana Power and Light* (1978) substantially expands the potential financial exposure of municipalities and other local government and quasi-governmental entities. Already the decision has generated an increase in antitrust challenges to acts of local governmental units. It will not be long before an antitrust count is just as automatic in suits challenging a municipal action as it is today in tender offer fights. Antitrust has indeed come to city hall.

Background

How did we get to this point? The Sherman Act—the first and most basic antitrust law—was passed in 1890, and even a cursory reading of its legislative history leads one to the conclusion that the Congress had no better idea of what it would produce than Congress has today on similarly complicated pieces of legislation. There was considerable confusion about the scope of the proposed law and substantial rewriting. Certainly, the whole question of anticompetitive conduct by municipalities was simply not an issue at the time. In fact, given the narrow view of interstate commerce and the strong notion that states were free to regulate commerce within their own borders, to talk of antitrust liability for municipalities would have been considered insane—and probably un-American.

But that was 1890, and this is 1979, and we have come a long way in between. Without arguing the merits of the change, there is no doubt that notions of the reach of the federal government's power under the commerce clause are far different today from what they were in 1890—or even in 1930. Now, even intrastate matters which affect interstate commerce are subject to federal power. And there can be no doubt that many actions by municipalities have effects far beyond their borders. New York City is the easiest example.

As Justice Brennan pointed out in his opinion for the Court in *City of Lafayette*, there are an extraordinary number of local government units in this country (some 62,437 in 1972), and any of them might, out of parochial economic self-interest, attempt to act to the detri-

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ment of private competitors. To permit them to do so without the constraining influence of the antitrust laws would, said Justice Brennan, create a "serious chink in the armor of antitrust protection. . . ."

The city of Lafayette argued, however, that it was a political subdivision of the state of Louisiana, drawing all its power and indeed its existence from the state, and thus was immune from federal antitrust prosecution just as if it were the state. The city invoked the so-called state action exemption, first enunciated by the Supreme Court in *Parker* v. *Brown* in 1943. There, in the first case dealing with the vulnerability of state regulation to antitrust prosecution, the Court (relying heavily on principles of federalism) concluded that state activities were not subject to attack as violations of the Sherman Act.

The Court was obviously concerned, however, that mere state involvement might be used to shield private conduct, and so it distinguished direct action by a state from the mere authorization by the state of a private restraint. In the case of a such a private restraint, the Court said that "a state does not give immunity to those who violate the Sherman Act by authorizing them to violate it or by declaring that their action is lawful." Thus, the nature of the state's activity determines the scope of the state action exemption.

Over the years, however, most courts did not scrutinize the actual nature of the state involvement, and the state action exemption gradually became a governmental involvement exemption. Practically any level of involvement by any kind of governmental unit would suffice to defeat a Sherman Act attack. In fact, one appellate court held that if a state agency had the opportunity to disapprove the challenged conduct and did not do so, the conduct was immunized from antitrust attack—even if it had never actually been reviewed by the agency (the "silence is golden" rule). Understandably, municipalities and other state or local governmental units paid little attention to antitrust issues. Under the state of the law at the time the *City of Lafayette* litigation began, it was not surprising that the city defended its conduct, not on the merits, but on the ground that it simply was not subject to the law.

Obviously, local governmental entities carry out a wide range of activities that can conceivably raise antitrust issues, from commercial activities like selling water and electricity to regulatory activities like zoning. But as long as state action had been deemed to be outside the antitrust laws, it had appeared that cities or airport authorities or state regulatory agencies must also be exempt, and almost all courts had held that they were.

Unfortunately for Lafayette, Louisiana, its timing was bad. In 1975, for only the second time in the eighty-five years since the passage of the Sherman Act, the Supreme Court looked again at the state action area, and this time the result was far different from what it had been before. Moreover, beginning in 1975, the Court became addicted to the topic, issuing at least one opinion in this area every year. The fourth in that series was *City of Lafayette.*

The first opinion (and in many ways the most important) was *Goldfarb* v. *Virginia State Bar*, in 1975. In *Goldfarb*, the conduct challenged was the publication of a minimum fee schedule by a county bar association and its enforcement by the Virginia State Bar. The Court rejected the attempted state action defense and, in so doing, set forth a new—and dramatically different—rule of law: "It is not enough that . . . anti-competitive conduct is prompted by state action; rather, anti-competitive activity must be compelled by action of the state acting as sovereign."

The *Goldfarb* decision and the Court's obvious concern that *Parker* v. *Brown* had been carried too far represented an abrupt change in course. Where courts had before looked for state involvement, they were now required to look for state compulsion. Where it had once been enough that a state agency could have disapproved conduct but did not, it was now necessary to find a state command requiring the conduct. The state bar eventually paid damages of $200,000, funded by assessments on its members—all the lawyers practicing in the state of Virginia.

Having picked up this ball that it had not touched for over three decades, the Court obviously wanted to run with it. In 1976, in *Cantor* v. *Detroit Edison*, it decided that even though a state utility commission had approved a utility company's tariff, the tariff was not exempt from attack under the Sherman Act, since the motivation for the practice came from the utility and not the state and since the state had no

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policy supporting the challenged conduct. While the *Cantor* decision was confusing, it did clearly reject the "silence is golden" rule. In 1977, the Court further complicated things by holding—in *Bates* v. *State Bar of Arizona*—that a rule prohibiting lawyer advertising, promulgated by the Arizona Supreme Court and subject to continuing evaluation by it, was indeed state action and thus exempt from antitrust attack. By this time, analysts were arguing over the significance of footnotes and commas, in a manner strongly reminiscent of arguments over constitutional law opinions.

No Municipal Action Exemptions

While the precise state of the law was difficult to determine, the trend was clear—the state action exemption was becoming narrower. *Goldfarb* and *Cantor* clearly put new limits on the use of the doctrine; and, while *Bates* seemed to go the other way, the state itself (through the co-equal judicial branch) is much more directly involved in regulating the conduct of lawyers than is the case with any other group. (In fact, in many states, *only* the judiciary can regulate lawyers, consistent with the state constitution.) But if "state action" was to be more narrowly defined for purposes of antitrust immunity, what about other governmental entities?

The Supreme Court's opinion in *City of Lafayette* echoes the reasoning of *Parker, Goldfarb,* and *Cantor.* But this case is significantly different. At issue here was not whether some state scheme of regulation was sufficient to cloak a private actor with the mantle of state action immunity, but whether a political subdivision of a state could, just because it was a political subdivision, claim immunity from the federal antitrust laws. The Court's answer was clear: there is no municipal action exemption from the antitrust laws. Any immunity that might exist is totally derivative, flowing from the nature of the state's involvement in the activity challenged. Only if the action can be said to be state action will immunity apply.

The Court's answer was clear: there is no municipal action exemption from the antitrust laws.

The Court pointed out that the mere fact that municipalities are political subdivisions of the state, drawing their power from the state, does not mean that all their actions are state actions. The very fact that a city typically has a range of policy options available to it demonstrates that its decision may represent its own preference, not the state's. Indeed, the Court said it could imagine situations where municipal action could be inconsistent with state policy. To grant antitrust immunity in such circumstances "would be a perversion of federalism."

The Court's treatment of one argument made by the city of Lafayette is an important key to understanding just how far this decision may take us. The city argued that antitrust protection was unnecessary since government is subject to political control—meaning that the people can take their complaints to the local or state legislatures. The Supreme Court found that argument "without merit":

> Mulcted consumers and unfairly displaced competitors may always seek redress through the political process. In enacting the Sherman Act, however, Congress mandated competition as the polestar by which all must be guided in ordering their business affairs. It did not leave this fundamental national policy to the vagaries of the political process, but established a broad policy, to be administered by neutral courts, which would guarantee every enterprise the right to exercise "whatever economic muscle it can muster," without regard to the amount of influence it might have with local or state legislatures.

Thus, the Court concluded that the *Parker* doctrine only exempts anticompetitive conduct "engaged in as an act of government by the state as sovereign, or, by its subdivisions, pursuant to state policy to displace competition with regulation or monopoly public service." As Justice Brennan summarized it:

> Our decision will render a State no less able to allocate governmental power between itself and its political subdivisions. It means only that when the State itself has not directed or authorized an anticompetitive practice, the State's subdivi-

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sions in exercising their delegated power must obey the antitrust laws.

Especially in the context of the other recent state action decisions, *Lafayette* opens up a myriad of decisions made by state or local governmental units to antitrust attack. These include (1) any regulatory activity, including occupational licensing, (2) the operation of sports arenas or convention centers, (3) the provision of water, electric, and other utility services, (4) garbage collection, (5) transit systems, including taxis, (6) public health services, (7) operation of airports, (8) operation of parking lots, (9) procurement practices generally, and, certainly not least, (10) zoning. Not all of these activities will in fact result in antitrust liability in every case, and some may never. But they all involve situations in which individuals or companies could reasonably say that actions by a state or local governmental unit have injured them unfairly, either because of the anticompetitive conduct of the governmental unit itself or because of collusion between the governmental unit and another private party.

Already, there have been a number of cases involving sports arenas and zoning laws. For example, the District of Columbia agency that operates RFK Stadium has an exclusive lease with the Washington Redskins; that arrangement was challenged by a promoter who wanted to set up another Washington professional football team. The agency defended on the state action issue and lost; the case is still pending (*Pro-Football Inc.* v. *Hecht*, 1977). Also, the various municipal corporations that operate the Pittsburgh Civic Arena, the Three Rivers Stadium, and the Greater Pittsburgh International Airport have been sued, along with an Allegheny County commissioner, for an alleged boycott of a particular brand of malt beverages in these municipal facilities. The complaint alleged a conspiracy to boycott among the municipal corporations, the county commission, and several private corporations that owned concession rights at the arenas and airport (*Duke & Co.* v. *Foerster*, 1975).

Another situation where a municipality or other local governmental unit might find itself involved in an antitrust problem is illustrated by *Kurek* v. *Pleasure Driveway and Park District of Peoria* (1977). There, five former golf shop concessionaires sued the Peoria Park District, accusing it of conspiring with another golf concessionaire to raise and fix prices at five district-operated golf courses. The district said it was immune from the antitrust laws because it was a state agency established by state statute, and the district court agreed. The Court of Appeals for the Seventh Circuit reversed the district court, saying that it could find nothing in the Illinois statutes on park districts "even remotely" suggesting that the state had "authorized, let alone compelled, park districts to attempt to enrich themselves by coercing horizontal retail competitors operating under concession licenses to fix retail prices in what would otherwise be plain violation of the Sherman Act."

The case of *City of Impact* v. *Whitworth* (1977) presents even more colorful facts. Impact, Texas, is a forty-seven-acre plot of former marsh land incorporated as a municipality in 1961 by a man named Dallas Perkins. At that time, almost all of the surrounding counties, as well as the largest local city, Abilene, were dry (Texas being a local option state). After incorporation, Impact voted 27–0 to go wet, and thereupon enacted a number of zoning and other ordinances which totally restricted the sale of alcoholic beverages to certain areas within the incorporated city. According to the complaint, all those areas were owned by Mr. Perkins and his co-defendants.

Impact has no public buildings, churches, or schools, and only five commercial buildings, four of them involved in the sale of liquor (the other is a grocery store). The five-member city council includes Mr. Perkins, his wife, his father, and two employees of the liquor stores. The town clerk is Mrs. Perkins. At the time this litigation began, the nearest place selling alcoholic beverages at retail was thirty-eight miles away.

When Mr. Whitworth bought property and applied for a liquor license, he was told that he could not have one because his property was zoned residential. Subsequently, he filed an antitrust suit, alleging that the zoning ordinances were the outcome of a conspiracy among the city incorporators and the liquor license holders to restrict competition in retail liquor sales.

The city argued that its action was a legitimate exercise of zoning authority and that, as a

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municipal arm of the state exercising governmental powers, it was immune from antitrust attack. The Fifth Circuit Court of Appeals said no: "The mere presence of the zoning ordinance does not necessarily insulate the defendants from antitrust liability where, as here, the plaintiff asserts that the enactment of the ordinance was itself a part of the alleged conspiracy to restrain trade." The court was careful to point out it was not passing on the merits of the alleged conspiracy; it was holding only that the allegations must be dealt with on their merits and could not be avoided by the interposition of the state action doctrine. Still, if a zoning decision can be challenged as an antitrust violation, a whole new subspecialty in real estate law may have been created—along with a great deal of confusion.

Likely Future Developments

City of Lafayette. This decision and the lower court opinions it is already spawning foreshadow a substantial increase in antitrust litigation involving decisions by municipalities—litigation that will increasingly have to be faced on the merits, without the shield of the state action exemption or any other immunity. To some extent, this litigation will be generated by federal and state antitrust enforcement authorities, as they seek to use this new opening to roll back anticompetitive municipal regulations. But probably more common—and certainly more important from a pocketbook perspective—will be litigation generated by private parties objecting to a local regulatory scheme or decision. The opportunity to use the automatic treble damages provision of the antitrust law against local governments will be difficult for many to resist.

... antitrust litigation involving decisions by municipalities ... will increasingly have to be faced on the merits. ...

It is very difficult to predict the likely outcome of these future cases because there are simply too many unanswered questions. For example, how will *City of Lafayette* be harmonized with *National League of Cities* v. *Usery* (1976)? In *Usery*, the Supreme Court held that Congress could *not* extend the coverage of the Fair Labor Standard Act's minimum wage and maximum hour provisions to employees of the states and their political subdivisions. Although the Court conceded that the federal government could ordinarily regulate to the full extent of the Constitution's commerce clause authority, it also declared that Congress was barred by the Tenth Amendment from exercising its power "in a fashion that impairs the states' integrity or their ability to function effectively in a federal system." Reasoning that the Fair Labor Standards Act "will significantly alter or displace the states' ability to structure employer-employee relationships in such areas as fire prevention, police protection, sanitation, public health, and parks and recreation," the Court held that application of the act to the states was barred by the Tenth Amendment.

The Court also implied that *Usery* had no application to state proprietary functions, stating:

> The holding of *United States* v. *California* [state operated non-profit railroad subject to the commerce clause based Safety Appliance Act] . . . is quite consistent with our holding today. There California's activity to which the congressional command was directed was not in an area that the states have regarded as integral parts of their governmental activities. It was, on the contrary, the operation of a railroad engaged in "common carriage by rail in interstate commerce" . . . .

Although *Usery* speaks of impermissible regulation of "states as States," its holding clearly protects municipalities as well. It thus appears that municipalities may be able to claim Tenth Amendment protection from application of the antitrust laws to their conduct *if* the laws interfere with "traditional aspects of state sovereignty," "essential governmental decisions," or "integral governmental functions." Although the exact meaning of these terms is unclear, it may be that proprietary functions do not fall within their scope.

This would certainly be consistent with Chief Justice Burger's concurrence in *City of Lafayette*. The chief justice thought the issue was much simpler than the plurality opinion

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would have it: the city was engaged in a proprietary, not a governmental, activity, and thus the antitrust laws were fully applicable. In fact, Chief Justice Burger cited *Usery* for the proposition that a "proprietary enterprise" was not an "integral operation in the area of traditional government functions." And since *Usery*, the Court of Appeals for the Second Circuit has held that a Tenth Amendment issue may arise even when the state disavows the conduct. Thus, even where the *Parker* state action doctrine is inapplicable, the *Usery* "integral government function" notion may mean that nonproprietary activities, like zoning, are free from antitrust attack. At least one district court has already reached that conclusion, citing the *Usery* decision.

Another fascinating issue is the extent to which the automatic treble damages provisions of the antitrust laws will be applied to actions by municipalities. Mr. Justice Stewart, in his dissent in *City of Lafayette*, called the decision an "extraordinary intrusion into the operation of state and local government in this country" that will "impose staggering costs on . . . municipal governments." Of course, that dire prediction assumes both that a high volume of municipal activity would be found to violate the antitrust laws and that the standard treble damages would apply in these cases. The first, if true, is troubling in itself; the second may not come to pass. In fact, the plurality opinion in *City of Lafayette* expressly reserved the question of appropriate remedies, saying that past cases "do not necessarily require the conclusion that remedies appropriate to redress violations by private corporations would be equally appropriate for municipalities."

Like Justice Stewart, I find it a little difficult to figure out how the Court might add meat to those bones without simply ignoring the language of section 4 of the Clayton Act, which provides that anyone injured by a violation of the antitrust laws *shall* recover "threefold" damages. But, of course, the answer may be just that—the Court might simply ignore the language of the statute, just as it has done in interpreting section 1983 of the U.S. Code—the basic civil rights statute.

Section 1983. This section provides that any person who, under color of state law, deprives a citizen or inhabitant of the United States of his rights under the laws or constitution of the United States *shall* be liable for the damages he has caused. Although the language of the statute is mandatory, courts have nevertheless granted qualified immunity to state prison officials (*Procunier* v. *Navarette*, 1978), state hospital superintendents (*O'Connor* v. *Donaldson*, 1975), local school board members (*Wood* v. *Strickland*, 1975), state governors, presidents of state universities, officers and members of state national guards (*Scheuer* v. *Rhodes*, 1974), and city policemen (*Pierson* v. *Ray*, 1967).

Courts grant such immunity because they fear two basic evils—a point explained by the Court in *Scheuer* v. *Rhodes* (the Kent State national guard case): (1) the inequity of opening up to liability the good faith actions of someone who must, because of the nature of his job, exercise discretion; and (2) the fact that allowing such liability might well result in an unwillingness to make the kinds of decisions required for the public good. As the Court explained in *Procunier* v. *Navarette* (on state prison officials):

> The official cannot be expected to predict the future course of constitutional law, . . . but he will not be shielded from liability if he acts "with such disregard of the plaintiff's clearly established constitutional rights that his action cannot reasonably be characterized as being in good faith."

In another 1978 decision (*Monell* v. *New York City Department of Social Services*), the Supreme Court held that the municipalities could be sued for damages under section 1983. Since that opinion, various lower federal courts have extended the qualified privilege, previously granted public officials, to municipalities. They reasoned that the legislative history of section 1983 as interpreted by *Monell* and strong policy reasons supported extension of the privilege.

In one of these recent cases (*Ohland* v. *City of Montpelier*, 1979), the district court concluded that Congress intended to impose liability under section 1983 only when the defendant acted wrongfully and only when liability could reasonably and justly be expected to deter that wrongful conduct. The court also noted the questionable deterrent effect of liability in a situation where the entity, by defi-

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nition, reasonably believed it had acted lawfully.

The court believed the privilege was necessary as a matter of policy because its absence "would paralyze decision-making with continual reference to advisory prognostications, the imposition of unnecessary procedural protections, and the avoidance of politically controversial issues. . . ." The court was also hesitant to "needlessly expand recovery at the expense of already overburdened taxpayers"—noting that

> taxpayers are not private investors willingly accepting the risks of doing business in return for anticipated profits. Moreover, governments, unlike businesses, cannot choose to avoid acting in areas of greater risk. . . . The losses that some persons may be forced to bear because [of the privilege] . . . are not fundamentally different from the losses that many individuals bear as in the areas of health and safety and economic regulation. . . . In all these cases, absent an explicit legislative determination that these losses will be shared, they should be considered part of the accepted risk attending governmental decision-making in a complex society.

Finally, the court rejected the argument that section 1983's mandatory liability language leaves no room to create a qualified privilege, concluding that the act's legislative history and public policy justify disregarding the act's language.

Several factors in these cases support the creation of a qualified privilege to municipal treble damage liability under the Sherman Act. First, as in constitutional law, it is difficult to predict the course of the Court's antitrust decisions. Moreover, in light of the inconsistencies between *Goldfarb* and *Bates*, and in light of the somewhat ambiguous nuances of *Cantor* and *City of Lafayette*, it is extremely difficult for a municipality to tell when the state has sufficiently compelled or contemplated its conduct to bring the municipality within the *Parker* exemption. In such cases, the twin evils described in the Kent State case are surely present, and it might be argued that municipalities should be relieved of treble damage liability if they reasonably and in good faith believe that their conduct is protected by *Parker*, or does not violate the Sherman Act for other reasons.

Indeed, municipal decision-making could be affected to a much greater degree by potential antitrust liability than it would be under section 1983, because the antitrust laws authorize treble damages while section 1983 authorizes only actual damages. Municipalities, unlike private parties, cannot reduce their exposure by failing to act, especially when state law requires them to act without compelling the actual result. Given the language in *City of Lafayette* indicating the Court's willingness to consider creating some sort of municipal defense to treble damage liability, it is certainly possible that Mr. Justice Stewart's dark vision of the future will not come to pass.

The issue is far from clear, however. The municipalities' privilege under section 1983 was created by drawing upon cases recognizing a qualified immunity for public officials under section 1983, but no similar privilege for public officials exists under the Sherman Act without a showing of state compulsion. With such a showing, no privilege is necessary because the state action exemption would come into play and no liability could exist. In addition, courts *created* the section 1983 privilege, despite the section's mandatory language, partly because it is consistent with congressional intent (as evidenced by the act's legislative history) to provide damages only for *wrongful* deprivations of constitutional rights. The antitrust laws, however, are not designed solely to bar wrongdoing but also to deter practices that have an anti-competitive effect upon commerce. To create a rule for municipalities different from that applied to all others accused of violating the antitrust laws would be a large step indeed.

Still, the Court has hinted in other contexts that it might move away from the mandatory treble damage rule. There is language in the *Cantor* opinion indicating that under certain circumstances the punitive impact of treble damages might be inappropriate. Similarly, Justice Blackmun, in his concurring opinion in *Cantor*, indicated that it might be a defense to damage liability to show that imposition of treble damages would be "unfair." Indeed, the Court has indicated a willingness in earlier cases to provide for the prospective application of damage liability when effecting a significant change in law (*Simpson* v. *Union Oil Co.*, 1964).

(Continues on page 60)

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Presidential Power and the Politics of RARG

Susan J. Tolchin

ONE EVENING in early May 1979, Stuart Eizenstat, head of the White House Domestic Policy Staff, called the Office of the Federal Register and, in a highly unconventional move, stopped publication of interim regulations about to be issued by the Department of Energy. The regulations in question were designed to implement the coal conversion provisions of the Power Plant and Industrial Fuel Use Act of 1978. There was no disagreement between the White House and the Department of Energy on the underlying aim of the statute—to encourage industry to convert to alternate fuels, like coal, where the price of those fuels did not "substantially" exceed the cost of using imported oil. But there was disagreement between them, as it turned out, on the appropriate definition of the key term "substantially." Though the spread between their respective targets might have seemed minuscule, the extra costs involved, in aggregate, could have given a nudge to the economy's chronic high inflation.

Stuart Eizenstat stopped the regulations because they had not gone through what has come to be known as the RARG process. "They had started to," said Eizenstat in a telephone interview, "but the process had not been completed. When I was alerted to the inflationary potential of those regs, I wanted more of a chance to study them in detail."

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The incident represented an important step in the Carter administration's program for managing the regulatory process. It also represented a breakdown in that effort.

Executive Order 12044, issued in March 1978, requires all federal agencies (except those formally independent of presidential control) to conduct economic impact analyses of their proposed regulations, whenever these may have a substantial impact on the economy. Though the order assigns the Office of Management and Budget the task of ensuring that such analyses are conducted, extensive review of their content is undertaken only by the Regulatory Advisory Review Group (RARG). It is a highly selective oversight, at that, for RARG is expected to consider no more than ten to twenty new regulations a year, chosen on the basis of their inflationary impact—that is to say, costing industry more than $100 million a year or establishing a precedent that may eventually produce costs on that scale if followed through.

Established in January 1978, the Review Group includes representatives of every cabinet department (except Defense, State, and Treasury) and top figures in the Office of Management and Budget (OMB), the Council of Economic Advisers (CEA), the Environmental Protection Agency (EPA), and the Office of Science and Technology Policy. An executive committee, whose members are drawn from OMB, CEA, and two other agencies (one regu-

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latory, the other economic) on a rotating basis, selects the particular regulations that will be examined by the group; and officials of the Council on Environmental Quality and the Domestic Policy Staff serve in an advisory capacity. The bulk of the analytical staff work is undertaken by economists from the Council on Wage and Price Stability (COWPS). CEA Chairman Charles Schultze, the original architect of RARG, serves as its official chairman, and his CEA colleagues seem to play the principal role in directing its activities. Participation by the other official members of the Review Group has varied considerably from one regulatory review to the next.

For the most part, the RARG process has worked without producing open conflict within the executive branch. But there have been formidable challenges from elsewhere—from members of Congress, as well as from special interest groups that have publicized their criticisms through the media and have initiated several lawsuits as well.

Clearly, RARG's modest success to date has depended almost entirely on President Carter's continuing personal interest and his willingness to exert his political muscle on its behalf. Every two weeks, White House aides send the President a memo updating the progress of the administration's regulatory management effort. "The administration has found that the fact that RARG is there to monitor the quality of the analyses has helped to improve them," noted Charles Schultze in testimony before the Senate Judiciary Committee in May 1979. Over the past year the RARG process has allowed White House economic advisers, backed by the President, to subject the most costly new regulations to extensive review and, through quiet interventions, to bring about reductions in their cost.

The Tightrope of Regulatory Management

As a management system, then, the RARG process has much to commend it. But as a political institution, it is in deep trouble. Its political vulnerability reflects two enduring controversies: the scope of the President's authority over the executive branch and the compatibility of White House intervention with the requirements of the Administrative Procedure Act.

It is apparent that, through the RARG process, the President hopes to establish hegemony over the regulatory actions of disparate agencies. It is equally clear that the process has been arranged to shield the President from political controversy by leaving the formal responsibility for particular decisions with the agency heads themselves. The challenge for the White House is to make the process serve these often divergent goals simultaneously.

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President Carter learned the political cost of direct personal intervention in a regulatory decision from his experience with the cotton dust rule in May 1978. The President publicly interceded to relax the standards chosen by Secretary of Labor Marshall (on the basis of proposals from the Occupational Safety and Health Administration) for maximum permissible levels of cotton dust in textile mills. The new standard came under intense criticism from labor unions, health groups, and industry —and, not surprisingly, most of the fire was aimed at Carter himself. Since then he has not intervened in a regulatory decision without covering his tracks.

White House officials claim that, before the Review Group was geared up, low-level bureaucrats were making the decisions but the White House itself—as the readiest focal point for public dissatisfaction—was being blamed for the consequences. The RARG process is designed to delineate the principal policy issues at stake in major regulatory initiatives as the White House economists see those issues. From there on, however, the idea is to keep public responsibility for decisions focused at the level of agency heads—thus shielding the President from subsequent political fallout.

One difficulty with the new strategy, though, comes when the agency head is as reluctant as the President to make an unpopular de-

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cision. It is generally believed, for example, that Douglas Costle, EPA administrator, stalled the new coal emission standards in the hope that the President would personally make the decision. Eventually, when EPA finally announced a decision in late May of this year, it precipitated one of the most intense battles to date over a regulation subject to the RARG process. Taking up the fight for those who view the compromise formula as an unnecessary risk to health and safety, the Environmental Defense Fund has formally requested EPA to reconsider its decision—on the grounds that it reflected improper White House influence—and threatens to file suit as a last recourse. The claim is that off-the-record discussions with White House officials, continuing after the official public comment period had closed, violated the intent of the safeguard provisions for agency rulemaking in the Administrative Procedure Act.

The same argument has been used in two legal challenges to the formulation of strip mining regulations. In the first, environmentalists unsuccessfully sought an injunction to stop closed, off-the-record meetings between Charles Schultze and Secretary of the Interior Cecil Andrus (*Natural Resources Defense Council* v. *Charles Schultze*, U.S. District Court for the District of Columbia, January 26, 1979). Subsequently, in a case now pending in the same court, environmentalists are alleging that off-the-record consultations between CEA and Interior Department officials "significantly affected the decision-making process" (*National Wildlife Federation* v. *Cecil Andrus*).

RARG's Status

Defenders of the Regulatory Analysis Review Group argue that its interventions end at the close of the public comment period, at which time its report is filed and put on the public record. "The real oversight occurs when RARG is hammering out its report," said economist Tom Hopkins of the Council on Wage and Price Stability. "However, further intervention by presidential advisers such as the CEA or COWPS chairman [as distinct from RARG] is possible after the comment period."

"In the strip mining case," Hopkins continued, "RARG ended its involvement after filing its report, but the CEA felt the issue was important enough to warrant a follow-through on the three or four issues RARG had identified. CEA staff then worked with Department of Interior staff in the interest of seeing that the final result was in keeping with the RARG report."

It is clear that the RARG process is intended to end when the public comment period ends. But the evidence still suggests that it does not, since one could easily conclude that RARG actually operates as an arm of the CEA, staffed by COWPS. In that sense, RARG does indeed function after the comment period ends, despite its formal fade-out. Even those who argue the reverse admit that RARG is the foundation for White House involvement throughout the regulation-drafting process.

"Public interest" groups do not object to the fact of post-comment period meetings so much as to the secrecy of these meetings. If EPA and CEA officials are discussing the Clean Air Act, for example, environmentalists want to know what happened at those meetings—what new considerations were introduced—so that they can know whether to press for a reopening of the comment period and a full opportunity to respond. Moreover, they fear that legal challenges to the final decision will be much more difficult if all the considerations that went into it are not on the record available to the reviewing court. That is the basic reasoning behind the charge that such off-the-record meetings violate the standards of due process envisioned by the Administrative Procedure Act.

A different point is made by the Capitol Hill foes of RARG who frame the dispute in terms of an overextension of presidential power. "The Constitution never envisioned the President as super-regulator. Yet, now the President is rewriting the laws, by deciding which ones are important and which are not," argued one legislative aide. "Should the President have the power to rearrange national objectives? Can he decide not to enforce the Clean Air Act because of inflation and unemployment?"*

"Presidents who plead helplessness are not being entirely honest," said Jim Graham, a staff aide with the Senate Governmental Affairs Com-

*This quotation and others where the speaker is not identified come from officials who wished to remain anonymous.

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mittee. "There are devices that enable the President to control the process. He can exert his influence through the budget or through hire-and-fire policy."

The White House, however, plainly finds these blunderbuss controls to be too unwieldy for the routine management of regulatory policy. But if the more extreme forms of control are legitimate, why should the subtler mechanisms of the RARG process be improper? In fact, the White House has discovered that there are very few legal precedents delineating the scope of direct presidential authority over the heads of executive branch agencies. Yet Carter would certainly not be the first President to claim authority to control the actions of all departments and agencies (except those with formal independent status). President Andrew Jackson, for example, dismissed two secretaries of the Treasury for refusing to carry out his policy toward the Bank of the United States. Jackson announced that he would continue to hire and fire secretaries of the Treasury until he found one who would do his bidding. "A Secretary," he said, "is merely an executive, an agent, a subordinate." In the end, Jackson had his way on banking policy, despite intense opposition from the Congress.

The argument can be readily applied to the current controversy over RARG. Since all agency decisions are ultimately made behind closed doors, and since agencies are part of the executive branch of government, what difference does it make whether the President intercedes early or late in the process of executing the laws? Among White House advocates of presidential power in the regulatory process, this is informally referred to as the "one big happy family theory." Those who subscribe to it argue that post-comment meetings need not be public because White House advisers and agency heads are part of the same team.

An unpublished memorandum from the Justice Department's Office of Legal Counsel, prepared in January 1979 for Interior Secretary Andrus, supports this view. The memo deals with the legality of consultations between the CEA and the Department of the Interior over rulemaking hearings under the Surface Mining Control and Reclamation Act (the strip mining act). It concludes—not surprisingly, since the Justice Department is also part of the executive branch—that in rulemaking hearings there is "no prohibition against communications within the Executive Branch after the close of the comment period on these proposed rules. Nothing in the relevant statutes or in the decisions of the D.C. Circuit suggests the existence of a bar against full and detailed consultations between those charged with promulgating the rules and the President's advisers."

The Policy Impact of RARG

Until a full-fledged court case puts the RARG process to the test, it is unlikely that we will know the full extent of White House involvement in agency decisions. But it is already clear that the pattern has varied somewhat according to the responsiveness of the agency involved. In some cases, it seems that the mere awareness of White House interest has been sufficient to influence a decision; in others, more solid brokering has had to go on to affect the outcome; and in still others (as with the Department of Energy), RARG has been ignored until a direct contest of power has occurred.

Even agencies that are influenced by the RARG process nevertheless point out that the influence may not be so great as it appears. Roy Gamse, an EPA staff analyst, argues that although RARG flagged the ozone emission standards for review, the group had virtually no impact on EPA's final decision of last January—despite a widespread public perception to the contrary. "The environmentalists think we caved in to White House pressure," said Gamse, "but the decision was our own and was based on scientific data, not the RARG report." Still, the standard was relaxed in the end, and many people insisted that the economic concerns of the White House were responsible.

Buffeted by competing claims and political pressures, RARG staffers have begun to soft-pedal the group's function, carefully using words such as "review," "coordinate," and "analyze" to describe RARG's oversight of economic/inflationary impact analyses. Strict cost-benefit analysis has given way in many instances to other forms of analysis, formulated in terms of the "most efficient" compromise, the solution that will bring about the least risk, and the "least cost" way of achieving it. In part this reflects technical difficulties in quantifying benefits and balancing the equation. But it also

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helps to deflect the criticism that decisions are dominated by cost factors at the expense of social concerns.

Nonetheless, the professional training of the White House economists clearly shapes their approach to regulatory oversight. And in private interviews they often do not conceal their disdain for the rigid approaches adopted by many of the agencies. "The first time an agency is 'RARGed,' it is like a cold shower," reported one CEA staffer. "Many have never done cost-benefit analysis and OSHA, for example, had at most only one economist in the whole agency." In general, the economists tend to favor the more flexible approaches that allow room for economic incentives without necessarily lowering standards. The modifications in OSHA's exposure standards for acrylonitrile, a carcinogen used in the manufacture of acrylics, are a good example. According to Bob Litan, who worked on this regulation at the CEA, OSHA had picked an exposure standard that was as high as possible without posing serious cancer risk. "We made the standard stricter," he said, "but used marketplace incentives and introduced flexibility so as to achieve the most cost-effective result." Critics insist, however, that cost-consciousness sometimes does mean a reduction in health and safety standards. And they warn that cost-benefit analysis often misleads by failing to include costs of inaction—in terms of increased illness, for example, with its ensuing costs in lowered productivity and increased medical expense.

"The first time an agency is 'RARGed,' it is like a cold shower," reported one CEA staffer.

The Broader Context

To ease the tension between the White House and the regulators and to bring the agencies closer to the administration's policy perspective, President Carter created the Regulatory Council in October 1978. Composed of top officials of both the cabinet departments and the leading regulatory agencies and chaired by EPA Administrator Douglas Costle, the council operates independently of RARG. Its principal function is to coordinate common regulatory approaches among agencies with overlapping responsibilities. Among its responsibilities is the publication of a semiannual calendar listing major forthcoming regulations—which, incidentally, RARG then uses to help identify its own candidates for review.

Initially, the creation of the Regulatory Council increased the conflict between White House advisers and the regulators. The economists at COWPS and CEA objected to being excluded from the council. But they soon realized that, if RARG was to function effectively, it needed at least the grudging support of key regulators. Bringing them formally into the process through the Regulatory Council seemed a good way to obtain their support. So far, in any case, the council does not appear to have posed a political threat to RARG and has, in fact, served as an important resource for RARG's staff. The council's staff director, Peter Petkus, a young lawyer who began his career in a Nader-affiliated public interest law group, claims that "since last fall there has been a much more cooperative spirit."

The most curious square in the patchwork of groups involved in regulatory management is OMB, originally cited in Executive Order 12044 as the agency principally responsible for overseeing compliance with its provisions. Yet according to staffers at COWPS, CEA, the Domestic Policy Staff, and at other agencies, OMB has had virtually no role at all. OMB officials become defensive when queried on the point. "I want to make perfectly clear that OMB has no intention of involvement in agencies," said Wayne Granquist, associate director for management and regulatory policy at OMB. "We wrote the executive order. We just want to make sure the tools are in place. We want the agencies to manage. We want the secretary of the interior not to file on the record in his own behalf, but as part of the administration."

To some extent, regulatory management is still a fragmented process, with power shared by the Domestic Policy Staff, COWPS, RARG, CEA, OMB, selected regulators, and—to the extent that information is power—the Regulatory Council. Although the President has put himself firmly behind the process, he has carefully avoided committing himself as to which of these groups (if any) should have predominant

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influence. In this connection, it is significant to note that the President's regulatory reform bill (S. 755) provides no central monitoring role for either OMB or CEA, although the bill extends the executive order in many other respects. Indeed, the administration has been relatively silent on the oversight issue generally.

The Political Prospects

"You have to realize that this is not a management or an engineering process," explained Peter Petkus, "but a political one." Whether the process survives at all will depend on how well its political difficulties are handled, for these clearly are more threatening to its effectiveness than are its legal vulnerabilities—at least in the short run. Though some of RARG's difficulties reflect relatively recent trends on the political scene, others can be traced to long-established patterns in national politics.

The older problems involve the traditions of congressional oversight. The sponsors of new regulatory statutes in Congress often feel an almost proprietary stake in the administrative or enforcement policies developed under "their" programs. Senator Edmund Muskie (Democrat, Maine), for example, as one of the authors of the Clean Air Act and the several clean water statutes, has continued to display a keen concern for the activity of EPA and has often exerted himself to defend the agency against pressures for compromise. In any case, with Congress having the last word on the budgets and legislative authorizations (or restrictions) of the regulatory agencies, the views of leading figures on a congressional oversight committee can often be more influential than the preferences of the White House. Conversely, when an agency does not like the direction in which it is being prodded by the President's staff, it can flee to congressional patrons for sympathy and support.

This situation often forced past administrations to engage in quiet bargaining with congressional "barons" to effect a change in regulatory policy or to develop a new rule along particular lines. These efforts were not always successful but defeat at least could be accepted without humiliation in most cases. In recent years, however, with the rising potency of single-interest advocates having ready access to the media, disagreements over regulatory policy may suddenly develop into heated public controversies. Clearly the setting within which the White House operates is harsher, more inflammatory, and more public now than it used to be. A President who presses EPA to take fuller account of economic costs, for example, may soon be branded an "enemy of the environment." Many critics insist that President Carter has compounded these inherent problems with his antiseptic and apolitical style of leadership. Taken together, these factors help create a political climate in which agency leaders may not be much inclined to antagonize special interest spokesmen or key figures in Congress simply to meet the suggestions of the President's economists.

White House officials claim it is unrealistic to expect dramatic changes at the outset from the new regulatory management efforts. As White House regulation expert Rick Neustadt says, the whole process is "like steering a supertanker. You may put the wheel over hard, but it's still not going to turn on a dime." But outsiders are inclined to be less patient. The criticism continues, the government is still frequently sued, and agencies like EPA or OSHA are regularly attacked for overzealousness or for selling out.

Ultimately, the problem with regulatory management is that the stakes are so high.

Ultimately, the problem with regulatory management is that the stakes are so high. With so many fields of activity now subject to intense federal regulation, the direction of policy may have a noticeable effect on the lives of millions of citizens and the disposition of many millions of dollars in economic resources. It is hard to imagine that any President would be able to make decisions of this magnitude in a management framework entirely isolated from political bargaining.

To its credit, the White House has made an ambitious start within the executive branch toward the redirection and closer management of the regulatory system. But whether it can in the long run solidify these gains and overcome the formidable political obstacles in its path still remains to be seen. ■

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A Book Review

Vouchers and Family Choice

Peter Skerry

DESPITE FREQUENT obituaries, the education voucher is an idea whose time has not yet passed. When first seriously proposed in the late 1960s, vouchers were intended to provide minority families with alternatives to the failing big-city schools. Now a decade later—despite the virulent opposition of teacher unions and the abortive federally sponsored experiment at Alum Rock, California—they have broad appeal to those who have grown increasingly disillusioned with the present system of public education.

The most recent and by far the most thoughtful contribution to the continuing debate over vouchers is from John E. Coons and Stephen D. Sugarman, two Berkeley law professors who have figured prominently in the school finance reform movement. In *Education by Choice: The Case for Family Control* (University of California Press, 1978), they propose a comprehensive voucher system that would provide all families with sufficient entitlements to send their children to almost any public or private schools they might choose. Published a little over a year ago, the book has met with a chorus of praise from liberals and conservatives alike—including columnist Russell Kirk, sociologist James Coleman, and Father Andrew Greeley.

But one wonders about this wholehearted reception. The difficulty may be that the voucher idea is largely untested by concrete experience and thus tends to be a kind of social policy Rorschach blot onto which individuals of widely divergent perspectives project their own views. This tendency is reinforced by the thoroughness of the authors' treatment. They present such an array of competing schemes and reasoned arguments that even the persevering reader is not always sure what they are advocating. The result is that many issues the book raises have received inadequate attention.

One such issue is Coons and Sugarman's suggestion that all participating schools be required to achieve minority enrollment quotas. This proposal, though contrary to the book's central notion of increasing choice in education, has escaped criticism. Moreover, given the authors' rejection of integration by force as "a failure of political imagination" and their insistence that there is sufficient prointegration sentiment in society today to make compulsion unnecessary, it is a curious proposal for them to make. Nevertheless, they are not content with strictures against discriminatory admissions policies or with incentives to encourage integration. And while they are undoubtedly correct that minority quotas imposed *on schools* would not arouse the intense opposition caused by racial assignment *of individuals*, their readiness to impose them should concern those who have turned to vouchers in exasperation with existing affirmative action programs.

Similarly, proponents who argue that vouchers will increase parental control of education have ignored Coons and Sugarman's emphasis on children's rights. As the authors point out, theirs is a *family* choice plan grounded on the view that educational decisions should not be made by parents alone. Setting themselves apart from what they call "parents' rights enthusiasts," they argue that all children should be consulted by their parents on such critical matters. Specifically, they advocate "the staged redistribution of legal authority, recognizing rights consistent with the developmental patterns of the normal child." Thus:

> at age twelve the child could enjoy a veto over the family's choice; at fourteen he could have choice, hence the initiative, but subject to parental veto; and at fifteen or sixteen he could be free to choose among all options recognized by the society as meeting his minimal needs.

It is, of course, difficult to quarrel with the proposition that parents should consider their

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children's wishes when selecting schools for them. But Coons and Sugarman offer no evidence why parents could not be trusted to do so under a voucher plan. Nor do they explain why the inevitable disagreements between parents and children could not be resolved without resort to legal remedies. The only apparent justification for replacing the informal bargaining on which all families rely with formalized rights for children is the authors' suspicion of parental authority. Indeed, their suspicion is so great that at one point they propose the establishment of an "educational inspectorate" to oversee decisions made under their family choice plan. The inspectorate might intervene when there was "evidence of either substantially below-minimum achievement by the child, or choices plainly inappropriate to his needs, or both." The authors do not elaborate, but presumably the child's achievement levels and needs would be determined by government.

In short, Coons and Sugarman's interest in the family is essentially pragmatic: they advocate family choice primarily as a means of decentralizing educational decision-making away from legislators and bureaucrats. That is, of course, a worthy objective. But the authors seem to lack any principled commitment to the family as an institution, as well as any awareness of the possible consequences of their legalistic proposals. Surely a state that can routinely enforce children's rights against their parents will do so and, in so doing, will aggrandize itself. Indeed, policies such as the authors advocate threaten to reduce the family to an appendage of the welfare state, valued only for its efficiency in realizing welfare objectives.

Another aspect of vouchers that has received little or no attention is their impact on the relationship between school and community. As Coons and Sugarman straightforwardly explain, the logic of their particular plan (which would permit attendance at any school, with transportation provided by the state) tends toward the demise of the local school district. In its place would emerge a myriad of formally autonomous schools, each with its own charter and educational mission. Parents would deal directly with schools attended by their children and, if displeased with a particular school, would move their child to another. If enough parents were displeased, the school would be forced to change or go out of business. In this way, as the authors note approvingly, a simple market mechanism would replace the political process by which schools are now governed.

At first glance this seems reasonable enough. But how would a family participating in this voucher plan influence a school short of removing its child, and would the threat of that action by any individual family have much effect? The answer is that dissatisfied parents would have to join together to get what they wanted. But if families with children attending a given school were dispersed over a wide geographic area, meetings would be hard, if not impossible, to arrange and common interests difficult to perceive and define.

There is nothing, of course, in the Coons-Sugarman proposal that would prevent parents from sending their children to neighborhood schools, and presumably most parents would do just that (as they did in the Alum Rock experiment). Nevertheless, a voucher plan—especially one providing transportation—would encourage many parents to send their children to more distant schools. To the extent that vouchers attenuated the link between community and school, would this be a positive development? Would the displacement of geographic community by "community of choice" be another step toward a society of atomized, individual interests? Perhaps the weakening of the local school district is a price worth the benefits of vouchers. But if so, this is a trade-off few voucher proponents have bothered to consider.

In recent years interventions at the local level by state and federal courts and agencies have resulted in much discontent with public education. A careful reading of *Education by Choice* suggests that vouchers could result in increased intrusion on parental prerogatives—while at the same time weakening the community base that now facilitates, however imperfectly, parental influence on the schools. Despite these serious problems, education vouchers remain an attractive alternative to the present system. Racial quotas and children's rights are, after all, not intrinsic to the voucher idea. Nevertheless, Coons and Sugarman's painstaking analysis—apparently in spite of itself—should warn those interested in vouchers that the educational market they anticipate could be heavily burdened with regulations as objectionable as those they now face. ■

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Readings
of particular interest

Final Senate Report on Regulation

U.S. Senate, *Study on Federal Regulation:* Volume 6, *Framework for Regulation* (Committee on Governmental Affairs, December 1978), 305 pp.; Appendix, 839 pp.

This sixth volume of the Senate Governmental Affairs Committee's study on regulation—prepared by economists Leonard Weiss of the University of Wisconsin and Michael Klass of the Federal Trade Commission—presents a framework for evaluating federal regulation. It finds some traditional justifications for regulation to be generally persuasive (natural monopoly conditions, overuse of natural resources, externalities, and inadequate information); and it finds others to be generally unpersuasive, except possibly in the short term (destructive competition, steeply rising prices, promotion of key industries, and protection of established rights). The authors distinguish between market failure rationales and social or "non-efficiency" rationales, accepting few of the latter as plausible grounds for regulation.

The economic impact of regulation is divided into direct costs—federal budgetary expenditures, costs of dealing with the federal agencies, compliance costs—and "indirect or unintended costs" (both general and industry-specific). Indirect cost impacts may be seen in excessive capital investment, excess capacity induced by artificially high prices, constraints on peak-load pricing, regulatory impediments to technological change, and decreased competition. The general inflationary effects of regulation-induced price increases are seen as a result of other costs and not as an independent category. The report suggests that such price increases may not take account of the benefits of some regulations. Various estimates of regulatory costs and benefits are discussed, and it is noted that these estimates frequently diverge too widely to be really helpful. Moreover, the costs of much economic regulation are substantial, while the benefits (particularly as estimated by the ICC) are often nonexistent or ill-defined.

In the chapter on "regulatory options for reform" the authors consider reduced or increased economic regulation, franchise bidding (as for radio stations), nationalization, and (very briefly) federal chartering. The chapter on "incentives versus standards" (almost a third of the book) examines the range of government incentives—for example, direct subsidies, tax preferences, user charges, and standard-setting—and includes discussions of effluent charges and marketable pollution rights. The authors generally prefer market-like solutions to command-and-control regulation and note that incentive mechanisms can be useful even in the safety and health areas. They also note that when the standards approach is considered necessary, compliance costs can be lowered and innovation encouraged by setting standards for performance rather than requiring design features. In discussing the transitional problems of deregulating or changing from one kind of regulation to another the report suggests, based on the CAB example in particular, that these problems may not materialize.

The general summary—besides applying the framework developed in the volume to the specific problem of hospital cost containment—offers some suggestions for determining when regulation is and is not justified. The conclusion is that natural monopoly conditions, "control of external effects," imperfect information, and the desire to prevent the excessive use of natural resources remain valid grounds for regulation or some form of government intervention, although the present means of control are not necessarily the most appropriate. Other justifications do not remain valid.

The volume's overall conclusion, presented in the introduction to the study, is that "much

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of federal regulation is justified." However, there is room for real improvement, particularly in economic regulation and also, though to a lesser extent, in health, safety, and environmental regulation. The larger purpose of the study is to "provide the substantive foundations for meaningful and beneficial regulatory reform."

"Hybrid Rulemaking" at the FTC

Report on Trade Regulation Rulemaking Procedures of the Federal Trade Commission, Part I, by Barry B. Boyer, Michael W. Bowers, Helene Toiv, Daniel J. Edelman, Bliss C. Cartwright, Carol J. DeVita, and Jamie M. Bennett (May 1979) (available from the Administrative Conference of the United States), Executive Summary, 45 pp.

The rapid expansion of agency rulemaking powers in recent years has given rise to a corresponding concern in Congress for developing ways to control bureaucratic lawmaking. The legislative veto, regulatory analyses, increased opportunities for public participation, and more intensive judicial review have all been advocated as methods of controlling administrative discretion. One of the major targets for these regulatory reform efforts has been the Federal Trade Commission, with its broad powers to prohibit "unfair or deceptive practices affecting commerce."

When Congress confirmed the FTC's power to issue consumer protection rules in 1974, it opted for a system of procedural restraints to limit the agency's discretion. Now, a study commissioned by the Administrative Conference of the United States and conducted by Barry Boyer of the Buffalo Law School indicates that this approach is not working.

The theory of the statute was to give interested persons the right to challenge the factual basis of a proposed rule in detail through cross-examination and written rebuttal submissions. The Administrative Conference report, which is the first half of a two-part study scheduled to be completed next year, identifies several reasons why this "hybrid rulemaking" process has failed to live up to the expectations of its draftsmen: Interested persons often found it difficult, if not impossible, to learn what the factual basis of a proposed rule really was. After the Magnuson-Moss Act was passed, the FTC launched a wave of ambitious rules designed to restructure trade practices in significant segments of the economy. Many of these rules were based on theories of "unfairness" that were poorly defined and poorly understood, even within the FTC; often, nobody was really sure what had to be proved, by whom, and on what kind of evidence. The confusion was compounded by gargantuan rulemaking records running into the hundreds of thousands of pages. This massive flow of paper overwhelmed the FTC's record-keeping system and frustrated users' attempts to track down key documents.

By limiting cross-examination at the hearings to the crucial facts in dispute, the statute tried to strike a balance between fairness to the regulated and administrative efficiency. Yet, according to the Administrative Conference study, this compromise attempt also was a failure. The FTC found the statutory language difficult to interpret and quickly gave up the effort to restrict questioning to key factual issues. Industry representatives, consumer groups, and FTC staff members were allocated blocks of time and given free rein to question witnesses on any topic they wished. Hundreds of witnesses testified in some of the rulemaking hearings and virtually all of them were subjected to lengthy questioning—including cross-examination on such topics as whether they believed in freedom of choice. The records grew even larger, and legal fees approached the half-million dollar mark for some industry groups resisting the rules.

Boyer and his research staff reserve final judgment on the FTC's hybrid rulemaking procedures until the completion of the second phase of their study—which will cover post-hearing procedures.

Framework for Reform

"Analyzing Regulatory Failure: Mismatches, Less Restrictive Alternatives, and Reform" by Stephen Breyer, in *Harvard Law Review*, vol. 92 (January 1979), pp. 547-609.

Many of the proposals for reform of regulation would not significantly change the "effect of the regulation on the regulated industries," writes Stephen Breyer of Harvard Law School. By de-

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veloping a framework for analyzing economic regulation, he hopes this article will aid policymakers in fashioning proposals for substantive change and in identifying those regulatory areas particularly in need of reform. The three parts of his analytic framework are market defects that provoke regulation, forms of classical regulation and their problems, and alternative methods that could be more successful than the classical forms. To illustrate the framework, Breyer discusses deregulation of the airlines, regulation of natural gas, pollution control, and the introduction of competition in the long-line telecommunications markets.

Too many arguments made in favor of government regulation assume that it is, at least in principle, "a perfect solution to any perceived problem with the unregulated marketplace." Breyer stresses the typical defects in the regulatory solution and outlines ways to correct the mismatches between the problem that provoked government intervention and the present form of regulation. His analysis focuses on the arguments used to justify regulation, not the conditions that cause it. He assumes an unregulated marketplace to be the norm, an assumption supported by "the intrinsic advantages offered by a well-functioning competitive marketplace." He also assumes that regulation is justified only if it achieves, without disproportionate costs, objectives that reasonable observers would regard as being in the public interest.

The predominant justification for government regulation of the economy has been classical market failure. After describing traditional regulatory responses to this failure, the author suggests alternatives that are, in his opinion, better matches for particular problems. For a natural monopoly (typified by some aspects of the telecommunications industry), he advises cost-of-service ratemaking; for "windfall profits" (as, recently, with natural gas), he finds taxes or deregulation preferable to traditional price and entry regulation; and for "spillovers" (pollution is one example), he recommends taxes, market-based incentives, and bargaining rather than standard-setting. In the case of "excessive competition" (for example, predatory pricing), he would deregulate and resort to antitrust enforcement to police prohibited practices. And where the problem is inadequate information, the use of disclosure regulation is to be preferred.

Breyer recommends that regulatory reform be pursued in three steps: (1) identify a situation where regulation is causing serious harm and where less restrictive alternatives could achieve the desired objectives, (2) produce a detailed empirical study of the regulated industry, and (3) assemble the necessary political support. The airline industry case is examined to illustrate the approach. The author notes that the congressional hearings on airline deregulation were particularly important because they provoked government agencies to focus on the problem and on a suitable policy, because they provided data for a comprehensive factual report that withstood attack, and because they attracted media attention and thus generated public support.

Breyer concludes that Congress can be effective in bringing about substantial reform. But there must be an intellectual framework for identifying a suitable candidate and for conducting a detailed investigation. Ultimately, reform requires "abandoning the simplistic view" that imperfect markets always justify governmental regulation.

Watching Out for "Immoral" Advertising

"The FTC Tantrum against Children's Television" by Christopher C. DeMuth, in *The American Spectator*, vol. 12 (April 1979), pp. 18-24.

The Federal Trade Commission is currently conducting a rulemaking proceeding based on a staff report that advocates a federal ban on all television advertising directed at children under eight. In this article, Christopher DeMuth of Harvard's Kennedy School of Government explores "how the FTC proposal fit[s] into the general trend of increasing government control of the economic life of the nation."

DeMuth concludes that regulatory programs today not only serve the traditional purpose of correcting for market imperfections but also interdict certain markets altogether in order to promote social or moral values. Often, debates about "market efficiency" cloak serious arguments about which *values* government will encourage or restrain.

The Federal Trade Commission Act of 1914 required the FTC to monitor and control eco-

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nomic effects and, in addition, to prevent "unfair methods of competition"—a vague statutory standard which, the author says, permitted the agency "to devote its energies not to antitrust matters, but to policing 'deceptive' advertising." In 1938, Congress ratified this practice by amending the act to prohibit "unfair or deceptive acts or practices" as well as unfair competition.

The rationale for regulating advertising truthfulness is that the buyer should be protected from misinformation or unequal information and that this protection would promote efficient markets. But, DeMuth asserts, the FTC's practice has fallen short of the theory: (1) Many of the commission's decisions have had the "baldly anti-competitive" effect of protecting established firms from new ones that are making "aggressive but essentially truthful" comparisons of their products with those of older firms. (2) The commission has pursued cases involving "hard-core" fraudulence where criminal penalties seem more in order than the FTC's mild administrative sanctions. (3) The commission has pursued frivolous cases, such as the challenge to Rapid Shave for its use of a mock-up to illustrate the shaving of sandpaper, a visual metaphor that communicated its message efficiently and entertainingly.

In the children's advertising case, the FTC claims that advertising directed at children under eight is inherently deceptive, because the child consumer does not understand that the advertising is designed to sell products and is therefore necessarily deceived. This "market failure" argument, DeMuth maintains, masks the FTC's true motive—eradication of what Chairman Michael Pertschuk calls an "immoral" commercial activity.

To account for the degree to which both liberals and conservatives accept government regulation to promote moral values in this case, DeMuth notes a shift from concern for market efficiency to interest in collective social manip-

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"Say, kids, speaking of stuff that's bad for you..."

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ulation. This bias, he says, is obviously not peculiar to those who gather at the FTC, or to those of similar anti-commercial bent who conduct the activities of other agencies. Ironically, even the most prosperous come to feel a radical discomfort with the free competitive economy. In the children's advertising case, this resentment of "other people's liberties"—in particular, the assertion of individual self-interest—has found a "target of opportunity" for its struggle against the "sweaty reality of the market."

DeMuth urges opponents of the advertising ban to assert the direct value to children of the free market, in which toymakers and advertisers enhance opportunities for play and in which parental authority is strengthened as it assumes responsibility for guiding children to appropriate choices.

Market and Non-market Failure

"A Theory of Non-market Failures" by Charles Wolf, Jr., in *The Public Interest*, Spring 1979, pp. 114-133.

Charles Wolf of The Rand Corporation undertakes to remedy the lack of a coherent, articulate theory of "non-market failure" to counterbalance the long-standing and powerful theory of "market failure" that has been so influential in extending regulation. By non-market, Wolf means activities undertaken by governments and other institutions with revenues derived from non-price sources. His purpose is to "facilitate comparisons between the inevitable shortcomings of the market and the no-less-inevitable shortcomings of non-market efforts to remedy them."

Market failures, defined as departures from efficiency or distributional equity, take one of four forms: (1) externalities or spillover effects, which can be negative, like noise or chemical pollution, or positive, like the social benefits of education; (2) increasing returns, which can occur in market situations where a single dominant producer with declining marginal costs has little incentive to increase output and lower prices; (3) market imperfections, that is, situations in which the real market differs notably from the theoretical expectations of perfect markets because, for example, consumers do not have access to adequate information; and (4) distributional inequities, which are not market failures in the technical sense but which are considered the key issue by many (although measurements of the success of the market are not normally concerned with distributional equity).

Wolf points out that non-market solutions have their own reasons for failure, reasons that are different from, but comparable to, those associated with market failure. Although non-market failure can be conceptualized using conventional market-failure principles, "distinctive supply and demand characteristics differentiate non-market outputs from market outputs." For example, it is extremely difficult to define the "products" of non-market activities; and because these products are often so hard to measure, there is a tendency to define them in terms of what produces them—their inputs. Other characteristics of non-market situations —the absence of consumer market behavior, as well as the lack of competition and of a profit maximization motive—add to the difficulty of "evaluating the performance of non-market production."

How do non-market solutions fail? Wolf identifies a system of "private goals" he calls "internalities," which are standards within non-market organizations that guide personnel and agencies and that are the criteria they use for evaluating their own performance. Internalities affect the success or failure of non-market activities just as externalities affect the success or failure of market activities, and each causes differences between actual outcomes and socially desirable outcomes. The author lists budget growth, technological advance, and information acquisition and control as three internalities. Although these are also associated to some extent with market activity, Wolf explains, price competition and intra-firm managerial competition limit the "role of cost-inflating internalities in the market." Non-market activities also tend toward failure in the form of "technically inefficient production and rising and redundant costs" as a result of the bureaucratic push to increase staff and output in the absence of a profit maximization constraint. Moreover, non-market solutions, like those produced in the market, frequently have unintended side effects: Wolf gives the example of a 1973 U.S. embargo on Japanese soybeans that adversely af-

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fected negotiations over military bases in Japan.

Non-market activities can themselves produce distributional inequities, but often in the form of influence and power instead of income or wealth (as in the market). An abuse arising from this kind of inequity is corrupt practices, which, he asserts, are common in the administration of import quotas or welfare programs. Another distributional inequity, one which involves income, is overcompensation of particular groups in a position to realize special advantages from policy measures that increase the demand for their services—defense and education being cases in point.

Wolf concludes by observing that a theory of non-market failure will help to "consider explicitly whether intervention is desirable at all, in light of prospects for non-market failure." And if intervention is found to be justified, the theory will suggest what might go wrong and thus make it possible to design better policy.

Federalism and Antitrust Enforcement

"State Action as a Shield and a Sword in a Medical-Services Antitrust Context: *Parker* v. *Brown* in a Constitutional Perspective" by James F. Blumstein and Terry Calvani, in *Duke Law Journal*, vol. 1978 (May 1978), pp. 389-441.

In this article, James Blumstein and Terry Calvani of Vanderbilt Law School reconsider the Supreme Court's decision in *Parker* v. *Brown* (1943) and propose a way of accommodating "the competing federal antitrust interests and state autonomy interests." In *Parker*, the Supreme Court held that the Sherman Act did not apply to state action because a federal statute will not be interpreted to nullify a state's authority over its officers and agents, without expressed congressional intent to achieve that result. Blumstein and Calvani point out that, when the Sherman Act was passed in 1890, the concept of "interstate commerce" to which it applied was a very narrow one, and the leading constitutional theory regarded interstate commerce and intrastate commerce as mutually exclusive preserves of federal and state regulatory authority. Hence, conflict between the substance of federal and state regulation was relatively rare. With the expansion in the accepted reach of the federal interstate commerce power, and with the acknowledgment of concurrent federal and state jurisdiction over many aspects of interstate commerce, the potential for such conflict has greatly increased and the significance of the *Parker* exception to the preemptive effect of the Sherman Act has become substantial.

Blumstein and Calvani treat the *Parker* decision as an implicit application of the eleventh amendment, which restricts suits against a state in federal court. The eleventh amendment approach helps explain why the governmental character of an antitrust defendant may determine whether liability exists. The authors also consider the reserved powers clause of the tenth amendment—as recently interpreted by the Supreme Court in *National League of Cities* v. *Usery* (1976)—to be another important basis for the exemption of state activity from federal antitrust challenges. They then summarize the dimensions of the state action exemption today: (1) an attribute of state sovereignty must be involved, (2) the state activity must be an essential governmental function, and (3) that state function must be impaired. Blumstein and Calvani conclude that *Parker* and subsequent cases do indeed insulate certain state activity from federal antitrust laws. (See "Antitrust Comes to City Hall," Joe Sims, page 35.)

But, the authors note, even when state action itself is immune, the effect of state action may be to render private conduct violative of federal antitrust law, by conferring on private entities market power that would not otherwise exist. Applying this reasoning to the medical services area, the authors assert the invalidity of tying arrangements under which patients cannot purchase any hospital service unless they agree to purchase all other medical services that they need from the same hospital. Section 1 of the Sherman Act has been held to render unlawful tying arrangements in which the tying product has "some advantage not shared by competitors." In the medical services area, the authors assert, that requisite market advantage has been conferred by state action—which, though it is itself exempt, does not immunize the private effects which it produces. The authors refer specifically to so-called certificate of need legislation, which seeks to avoid overcapacity by restricting the ability of

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some hospitals to acquire certain equipment and to provide certain services. Those hospitals favored with certification are given the market power to tie use of the certified equipment or services to the purchase of other services which are competitively offered. According to the authors, *Parker* v. *Brown* would not insulate these private actions, even though the state certification scheme itself is immune.

Blumstein and Calvani's analysis suggests that the import of the Court's decisions in this area of state-assisted private action is that "federal interests prevail over state regulatory policies except where an essential state governmental function is established which cannot be performed by less anticompetitive means." They argue that their interpretation represents a proper accommodation of competing interests and a manageable standard for approaching the question of anticompetitive state conduct.

Broadcasting and the "Unfairness Doctrine"

The Fairness Doctrine and the Media by Steven J. Simmons (Berkeley, Calif.: University of California Press, 1978), 250 pp.

Steven Simmons, now with the White House Domestic Policy Staff, recounts the legislative, judicial, and administrative history of that aspect of communications law known as the fairness doctrine. He cites case law and legislative history as a basis for his unconventional conclusion that the doctrine emerged in the *early* years of broadcasting. Further, he offers a critique of the doctrine and recommendations for major changes in the law.

Administered by the Federal Communications Commission, the fairness doctrine developed from the rationale that the "public interest" required a substantial and balanced presentation of political and social issues over the airwaves, a scarce public resource. According to the author, the doctrine requires that broadcast licensees not only ensure fairness by providing "an opportunity for the presentation of contrasting points of view" (the "balance" requirement), but also that they "devote a reasonable percentage of . . . broadcast time to coverage of political issues." Simmons believes these admirable objectives have not been adequately realized because of underregulation of coverage and overregulation of balance.

First, the requirement for coverage of public issues has been so cautiously administered, Simmons reports, that until 1975 the FCC had found not a single licensee in default of its responsibility. To prevent the dual problems of licensee avoidance of public affairs programming on the one hand and First Amendment abuse by government intervention in programming on the other, the author recommends that the 1934 Communications Act be revised to require (1) that a relatively high percentage of programming be devoted to news and public affairs, but (2) that content and format be left to the discretion of broadcast journalists, with the sole caveat that the licensee ascertain and consider community needs.

Second, the "balance" requirement has been actively enforced, but in ways that have failed to ensure true program balance, while inhibiting broadcasters from attempting more than minimal public affairs programming. Take, for example, the personal attack and political editorial rules, which require on-air responses if the licensee attacks an individual or a group or endorses one candidate to the exclusion of others in a political editorial. Broadcasters must make intricate judgments as to what programming is subject to these rules, and what is necessary to provide the required "balance" with respect to the nature of the response, the identity of the spokesman, and the format, frequency, and scheduling of the response. The licensee is in constant jeopardy of the time-consuming and expensive litigation that ensues upon a complaint, even though complainants are rarely successful. (In its decisions as to what constitutes balanced programming, the FCC relies extensively on the "reasonable, good-faith judgment of the individual licensee.")

Simmons argues that all balance requirements (except for responses to explicit broadcast editorials) could be dropped from the fairness doctrine with no loss of listeners' rights to be informed of varied viewpoints. There are more than four radio and television outlets nationwide for every newspaper, so why, he asks, cannot political expression vary from station to station, as it does from newspaper to newspaper, rather than within each station? Moreover, Simmons observes, airwave scarcity is giving

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way, as it should, to the technology of abundance (through developments like cable TV), so that the fairness doctrine will ultimately become irrelevant to its original purposes. An abundance of communication outlets is, in the long run, a far better way to reconcile media access demands with broadcasters' First Amendment rights than government intervention in an individual station's daily programming.

Mandating Standards

Economic Effects of Government-Mandated Costs, edited by Robert F. Lanzillotti (Gainesville, Florida: University Presses of Florida, 1978), 222 pp.

This book is composed of papers and comments presented at a 1977 University of Florida seminar on government-mandated costs. The editor, Robert Lanzillotti (of the university's Public Policy Research Center) points out that, in spite of growing concern for government regulation of business, there has been an increase in government controls over the "private and traditionally non-regulated sector," essentially through mandated standards.

In discussing government-mandated inflation, Murray Weidenbaum of Washington University (St. Louis) outlines ways of looking at the microeconomic consequences of regulatory programs so as to reconcile the goals of specific programs with national objectives. He describes alternatives to regulation, including voluntary codes of behavior and taxes on pollution, but does not think that eliminating regulation in safety, ecology, and related areas is a "realistic alternative in view of the nation's long-term social goals." A companion paper by Roger Noll of the California Institute of Technology considers the reasons why standards rather than incentives are chosen as a means of achieving social goals. His conclusion: it is not so much a question of principle as of practicality.

Nina Cornell of the Council of Economic Advisers contributes a brief talk arguing that the standard-setting approach, when used alone, is ineffective for achieving safety goals. John Morrall III of the Council on Wage and Price Stability maintains that "benefit-cost analysis . . . should be a major consideration in standard setting"—even for OSHA (an agency that refuses to use cost-benefit analysis), because opposition to its standards is "directly proportional to the potential costs of compliance."

Jacqueline Karnell Corn and Morton Corn of the University of Pittsburgh review the history of mandating standards and regulations affecting human health and put U.S. policies into this historical context. They see OSHA as the end product of sixty years of agitation to achieve a "safe hazard-free workplace" and as embodying a change from the view that injury is the responsibility of the employee.

Milton Kafoglis, now of Emory University, considers the impact of the technological (or standards) approach on small business. Although the data are insufficient for firm conclusions, the indications are that the regulatory process "favors large business" and that performance standards would be better than design standards for reducing the bias.

Ray Gamse of the Environmental Protection Agency evaluates the economic effects of the EPA's program, finding that there is ample information on costs ($259 billion for 1975–84, according to one estimate) and very little information on benefits. One reason for the latter is the difficulty of converting environmental benefits into dollars and cents. In the last paper, Thomas R. Saving of Texas A&M University discusses the regulation of the quality of products and of working conditions. He argues that the premises giving rise to this regulation rarely justify the imposition of standards, and demonstrates, using marginal analysis, that there are genuine losses in social welfare from a standard-setting approach.

Costs of Regulating Hospitals

Cost of Regulation: Report of the Task Force on Regulation (Albany, N.Y.: Hospital Association of New York State, 1978), 83 pp.

According to the Hospital Association of New York State, this study is the "most comprehensive" of its kind "ever undertaken." Questionnaires pinpointing thirty-four areas of hospital operations were distributed to 285 acute-care institutions in New York state. Of this number, a total of 148 (or 52 percent) responded—"a high rate given the complexity of the survey instrument. . . ." The overall purpose

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of the survey was to examine regulatory costs in New York's hospital industry for the year 1976. In describing the study, the report notes that it was necessarily state-specific because regulatory requirements differ from state to state—with New York having one of the most highly regulated hospital industries in the country. Moreover, as the report stresses, the need for regulation in an "industry so vested with the public interest" was assumed.

Several limitations to the study are set forth for the reader. Perhaps most important is the fact that the category of costs producing the largest figures, "service-related activities required by regulation," includes all activities necessary to comply with legal requirements, without distinguishing those activities that would normally be performed in keeping with good hospital practice. Other limitations are the possibility that some respondents misunderstood some questions, the possibility that anti-regulatory bias led some respondents to overstate regulatory burdens, and the need for caution in applying findings to other states.

Notable among the study's findings are the following:

(1) 25 percent of hospital costs in the state are a result of meeting government regulatory requirements;

(2) almost 24 percent of all hospital man-hours are devoted to regulatory matters;

(3) registered nurses spend 25 percent of their time on regulatory matters;

(4) the cost to New York hospitals and the patients they serve is over $1.1 billion a year;

(5) the administration, personnel, social services, and utilization review departments each spend over 50 percent of their budgets on meeting regulatory requirements.

The study found no significant difference in these costs in different parts of New York state or in institutions of different sizes.

"Forms and reports" turned out to be the second largest category of hospital regulatory costs and the one where changes "will have the largest savings impact." In 1976, respondent hospitals spent a total of 700,000 compliance hours on completing forms and reports, much of it done by supervisory staff. Many regulations (including required forms and reports) were said to be conflicting, overlapping, and unrelated to effective health-care delivery.

Antitrust Comes to City Hall

(Continued from page 41)

Finally, of course, it remains to be seen what actions that might be challenged will ultimately be held to create liability. The antitrust laws incorporate what is known as a "rule of reason" against which particular restraints are measured; this standard gives the Sherman Act "both flexibility and definition" (*United States* v. *National Society of Professional Engineers*, 1978). Under a rule of reason analysis, the particular restraint is evaluated "by analyzing facts peculiar to the business, the history of the restraint, and the reasons why it was imposed." Thus, a restraint imposed in the context of a governmental regulatory scheme would be scrutinized within that context and with some deference to the legitimate functions of the governmental entity.

The Shape of Things to Come

In sum, antitrust and competition policy—long familiar concepts to federal regulators—must now become familiar to state and local agencies as well. The current uncertainty merely emphasizes the urgency with which state and local government agencies and officials ought to be examining the regulations and rules for which they are responsible. This new problem will make their life more difficult, but in the end may also help make their decisions better focused and more apt to be in the public interest.

In sum, antitrust and competition policy—long familiar concepts to federal regulators—must now become familiar to state and local agencies as well.

The story is told of the trade association representatives who approached a state governor several decades ago, seeking status as a licensed profession. When the governor asked whether the step they sought would be to their advantage or that of the public, they answered "a little of each." From now on, state and local government officials will have to weigh the "little of each" carefully to see where the balance really lies. It will not be easy. The law schools are very happy. ■

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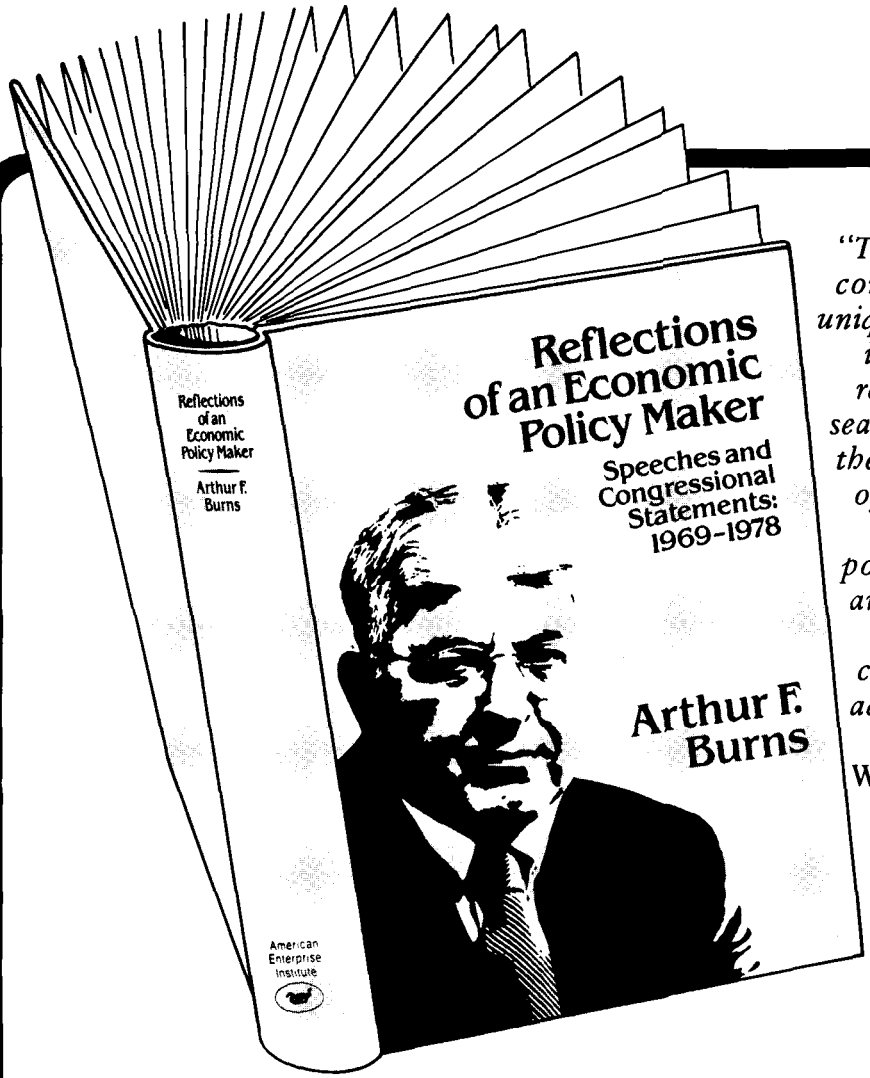
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